TRANSCRIPT OF RECORD

19

Supreme Court of the United States

OCTOBER TERM, 1928

No. 554 16

ELIZABETH C. TAFT, PETITIONER,

vs.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF THE STATE OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED SEPTEMBER 26, 1927

CERTIORARI GRANTED NOVEMBER 21, 1927

(33,006)

(33,006)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927

No. 554

ELIZABETH C. TAFT, PETITIONER,

vs.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF THE STATE OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

INDEX

	Original	Print
Record from the district court of the United States, southern New York	1	1
Writ of error	1	1
Summons	3	2
Amended complaint	4	3
Motion to dismiss	10	6
Notice of motion to dismiss	11	7
Opinion, Knox, J	12	7
Order denying motion to dismiss	15	9
Judgment	17	10
Certificate of probable cause	19	11
Petition for writ of error	20	12
Assignments of error	22	12
Citation (omitted in printing)	24	
Stipulation re transcript of record	25	14
Clerk's certificate (omitted in printing)	26	
Proceedings in the United States circuit court of appeals, second circuit	27	14
Opinion, Manton, J	27	14
Concurring opinion, Hand, J	31	20
Dissenting opinion, Swan, J	33	22
Decree	35	24
Clerk's certificate (omitted in printing)	37	
Order allowing certiorari	38	24

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., DECEMBER 16, 1927

[fols. a-1]

IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

WRIT OF ERROR

UNITED STATES OF AMERICA, ss:

The President of the United States of America to the Judges of the District Court of the United States for the Southern District of New York, Greeting:

Because in the record and proceedings as also in the rendition of the judgment of a plea which is in the District Court before you, or some of you, between Elizabeth C. Taft, plaintiff, and Frank K. Bowers, Collector of Internal Revenue for the Second District of the State of New York, defendant, a manifest error hath happened to the great damage of the said Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, as is said and appears by the complaint. We being willing that such error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the Judges of the United States Circuit Court of Appeals for the Second Circuit, at the City of New York, together with this writ, so that you have the same at the said place, before the Judges aforesaid, on the 16th day of December, 1926, that the record and proceedings aforesaid being inspected, the said Judges of the United States Circuit Court of Appeals for the Second Circuit may cause further to be done therein, to correct [fol. 2] that error, what of right and according to the law and custom of the United States ought to be done.

Witness the Honorable William H. Taft, Chief Justice of the United States, this 17th day of November, in the year of our Lord one thousand nine hundred and twenty-six,

and of the Independence of the United States the one hundred and fifty-first.

Alex. Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, in the Second Circuit.

The foregoing writ is hereby allowed. Henry W. Goddard, U. S. District Judge.

[fol. 3] IN UNITED STATES DISTRICT COURT

L. 35, Page 86

ELIZABETH C. TAFT, Plaintiff,

against

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York, Defendant

SUMMONS

To the above-named defendant:

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer, or, if the complaint is not served with this summons, to serve a notice of appearance, on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service. In case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Witness the Honorable Augustus N. Hand, Judge of the District Court of the United States for the Southern District of New York, at the city of New York, this 31st day of January, A. D. 1925.

Alex. Gilchrist, Jr., Clerk.

Cadwalader, Wickersham & Taft, Plaintiff's Attorney-. Office and Post Office Address: 40 Wall St., Borough of Manhattan, New York City.

[fol. 4] IN UNITED STATES DISTRICT COURT

[Title omitted]

AMENDED COMPLAINT

The plaintiff by her attorneys, Cadwalader, Wickersham & Taft, for her amended complaint respectfully alleges:

1. That the plaintiff was at the time of the beginning of this action a citizen of the State of New York, and a resident of the Southern District of the State of New York.

2. That the defendant was at the time the tax hereinafter mentioned was assessed and collected, and still is, Collector of Internal Revenue for the Second District of New York, and is an inhabitant and resident of the Southern District of New York.

3. That on or about December 12, 1921, plaintiff's father gave to her one hundred (100) shares of the common stock of The Nash Motors Company, a corporation organized and existing under the laws of the State of Maryland; and on or about March 18, 1922, he gave her fifty (50) additional shares of the same class and kind of stock of The Nash [fol. 5] Motors Company. Said shares were transferred on the books of the corportion to the plaintiff's name, so that on December 26, 1922, she was the owner of record of one hundred fifty (150) shares of the said common stock of The Nash Motors Company.

4. That on or about February 1, 1923, The Nash Motors Company declared a stock dividend of four shares of common and three shares of preferred stock on each share of common stock to stockholders of record on December 26, 1922. Accordingly the plaintiff received during 1923 as a stock dividend six hundred (600) shares of common stock and four hundred fifty (450) shares of preferred stock ot The Nash Motors Company, so that she then was the owner of record of seven hundred fifty (750) shares of common and four hundred fifty (450) shares of preferred stock of The Nash Motors Company.

5. That during the year 1923, and after the receipt of said stock dividend, plaintiff sold two hundred (200) shares

of said common stock and one hundred thirty (130) shares of said preferred stock of The Nash Motors Company for Thirty-four thousand three hundred forty-five Dollars and thirty Cents ($34,345.30).

6. That on or before March 15, 1924, the plaintiff filed with the defendant her individual income tax return for the year 1923, showing a net income of $40,972.75 and included therein the entire proceeds of such sale, to-wit, Thirty-four thousand three hundred forty-five Dollars and thirty Cents ($34,345.30).

7. That on or before June 13, 1924, the plaintiff paid to the defendant, under protest, the entire amount of tax cal- [fol. 6] culated to be payable on the basis of said return, to-wit, Four thousand three hundred twenty Dollars and fifty Cents ($4,320.50).

8. That the total market value of said one hundred fifty (150) shares of common stock of The Nash Motors Company received by gift by the plaintiff on the date that the said shares were so acquired by her was Forty-two thousand three hundred fifty Dollars ($42,350); that the proportion of this amount allocated according to the regulations of the United States Treasury Department to the two hundred (200) shares of common stock of The Nash Motors Company sold by her in 1923 is Six thousand three hundred six Dollars ($6,306), and the proportion of the said value allocated to the one hundred thirty (130) shares of preferred stock of The Nash Motors Company sold by her in 1923 is Five thousand four hundred two Dollars and eighty Cents ($5,402.80), in all Eleven thousand seven hundred eight Dollars and eighty Cents ($11,708.80).

9. Upon information and belief that the plaintiff's father, from whom she acquired one hundred fifty (150) shares of the common stock of The Nash Motors Company, acquired said stock as a bonus in connection with the purchase by him of shares of preferred stock of The Nash Motors Company at or about the time of its incorporation, in 1916, and the said common stock had at that time no market price or value in his hands, and on a subsequent sale of any of the said common stock by the plaintiff's father, he has returned the full proceeds of sale as income.

10. That the income tax paid by the plaintiff to the de-
[fol. 7] fendant on the said Eleven thousand seven hundred eight Dollars and eighty Cents ($11,708.80) thus included in her income for the year 1923, was Two thousand forty Dollars and nine Cents ($2,040.09).

11. That on or about June 13, 1924, and within the time prescribed by law, plaintiff duly took an appeal to the Commissioner of Internal Revenue by filing with the defendant a claim for refund of the said tax so paid, to-wit, Two thousand forty Dollars and nine Cents ($2,040.09), or such larger amount as is legally refundable.

12. That more than six months have elapsed between the time of filing the said claim and the beginning of this action, and no decision has been made by the Commissioner of Internal Revenue on said claim.

13. Upon information and belief, that Eleven thousand seven hundred eight Dollars and eighty Cents ($11,708.80), out of the proceeds of the sale of said two hundred (200) shares of the common stock and one hundred thirty (130) shares of preferred stock of the Nash Motors Company so sold by the plaintiff in 1923, is a return of capital, and is not income to the plaintiff.

14. That the assessment and collection by the defendant of an income tax of Two thousand forty Dollars and nine Cents ($2,040.09) from the plaintiff upon said Eleven thousand seven hundred eight Dollars and eighty Cents ($11,-708.80), was illegal, erroneous and contrary to the law and in particular to the Sixteenth Amendment of the Constitution of the United States.

[fol. 8] 15. That in so far as Section 202 (a) (2) of the Revenue Act of 1921 required that in computing gain from the sale of capital assets a donee of such assets must include as income any increment of value accrued before acquisition by such donee, it resulted in a direct tax upon capital without apportionment and was in contravention of Article 1, Sections 2 and 9 of the Constitution of the United States, and of the Fifth Amendment to the Constitution of the United States.

16. That no part of the said sum of Two thousand forty Dollars and nine Cents ($2,040.09) has been repaid to the plaintiff, and the whole amount thereof, with interest thereon from June 13, 1924, remains due and owing from the defendant to the plaintiff.

17. That this is a suit of a civil nature at common law, and the suit and cause of action herein set forth arises under the laws of the United States providing for internal revenue, and the Constitution of the United States.

Wherefore plaintiff demands judgment against the defendant for the sum of Two thousand forty Dollars and nine Cents ($2,040.09), with interest thereon from the 13th day of June, 1924, together with the costs and disbursements of this action.

Cadwalader, Wickersham & Taft, Attorneys for the Plaintiff. Office and Post Office Address: 40 Wall Street, Borough of Manhattan, New York City.

[fol. 9] *Duly sworn to by Elizabeth C. Taft. Jurat omitted in printing.*

[fol. 10] In United States District Court

[Title omitted]

Motion to Dismiss

Now comes the above named defendant by his attorney Emory R. Buckner, United States Attorney for the Southern District of New York and moves to dismiss the amended complaint herein upon the ground that the said complaint does not state facts sufficient to constitute a cause of action.

Dated New York, June 25, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant. Office & P. O. Address: U. S. Courts & P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 11] In United States District Court

[Title omitted]

Notice of Motion to Dismiss

Sir: Please take notice that the motion to dismiss the amended complaint herein upon the grounds that said amended complaint does not state facts sufficient to constitute a cause of action, made up and on behalf of the defendant under date of June 25, 1926, will be brought on for hearing at a term of the United States District Court for the Southern District of New York at the old Post Office Building in the Borough of Manhattan, City of New York, on the 20th day of July, 1926 at 10:30 A. M., or as soon thereafter as counsel can be heard.

Dated New York, June 25, 1926.

Yours, etc., Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant. Office & P. O. Address: U. S. Courts & P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 12] To Cadwalader, Wickersham & Taft, Esqs., Attorneys for Plaintiff, 40 Wall Street, Borough of Manhattan, City of New York.

In United States District Court

[Title omitted]

Cadwalader, Wickersham & Taft, Esqs., Attorneys for Plaintiff (Henry W. Taft and Clarence Castimore, Esqs., of counsel).

[fol. 13] Baldwin, Hutchins & Todd, Esqs., Attorneys for Plaintiff (Robert A. Young and E. Raymond Shepard, Esqs., of counsel).

Hon. Emory R. Buckner, United States Attorney, Attorney for Defendant (Sherwood E. Hall, Esq., Asst. United States Atty., of counsel).

OPINION

KNOX, D. J.:

It is my opinion that no part or portion of the value of an outright bona fide gift as of the date of delivery is, or can, constitute taxable income in the hands of the donee. So far as the latter is concerned, the gift is a capital transaction. His liability for future income therefrom must be based on the value of the gift as of the time the transaction is complete, and not upon the cost of the property at the date of its acquisition by the donor. If the construction of the tax law, for which the Government contends, should be applied, it means that the donee of property is to be taxed upon an increment in value which, if it can be regarded as income at all, is income to another, viz.—the donor. A tax levied upon that increment in the hands of the donee necessarily results in a direct levy upon the gift. If the gift consisted of money, would it be argued that the donee is to be taxed on the difference in value of the money, that is, its purchasing power, as between the date of its acquisition by the donor, and the date of its delivery to the donee? I think not. The money would be regarded as capital in the hands of the donee; and so, I think that that which may be converted into money, as of the date upon which it is given away, must, so far as the donee is concerned, also be regarded as capital.

According to my views, the 16th Amendment to the Con-
[fol. 14] stitution conferred no power upon the Congress to tax gifts.

Very likely, it is possible to devise reasonably plausible arguments to the effect that what is transferred by the donor is nothing more than his original investment therein, and to cite various decisions which contain expressions that may be tortured to support the argument; but the fact remains that the common understanding of a gift is that the donee acquires, absolutely and completely, the entire value of the donation as of the date of transfer. Until a higher court than this is willing to endorse a different principle, I certainly shall not do so.

The motion to dismiss the complaint is denied and the plaintiffs may have judgment for the claim asserted against the Collector. He, of course, will be granted a certificate.

August 5, 1926.

(Signed) Jno. C. Knox, U. S. D. J.

[fol. 15] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER DENYING MOTION TO DISMISS—August 16, 1926

L-35, Page 86

Present: Hon. John C. Knox, District Judge.

The defendant above-named having moved this Court by Notice of Motion, dated the 25th day of June, 1926, for an order granting to said defendant judgment dismissing the Amended Complaint herein upon the ground that said Amended Complaint does not state facts sufficient to constitute a cause of action, and said motion having come on to be heard before Honorable John C. Knox, one of the Judges of this Court, on the 20th day of July, 1926 in the Court Room of this Court in the old United States Post Office [fol. 16] Building, Borough of Manhattan, City of New York, and after hearing Sherwood E. Hall, Esquire, of counsel for the defendant in support of said motion and after hearing Henry W. Taft, Esquire, of counsel for the plaintiff in opposition thereto, and the Court after due deliberation having rendered its opinion on the 5th day of August, 1926 that the said Amended Complaint states facts sufficient to constitute a cause of action;

Now, upon reading said Notice of Motion and the said Amended Complaint and upon said opinion of this Court, all of which have been heretofore filed with this Court, and upon motion of Cadwalader, Wickersham & Taft, attorneys for the plaintiff, it is

Ordered that said motion to dismiss said Amended Complaint be and the same is hereby denied, and it is further

Ordered that the plaintiff may enter judgment against the defendant for the sum of Two thousand forty and 09/100 Dollars ($2,040.09), with interest thereon from the 13th day of June, 1924, together with the costs and disbursements of this action.

John C. Knox, U. S. D. J.

[fol. 17] IN UNITED STATES DISTRICT COURT

[Title omitted]

JUDGMENT

The defendant above named having moved this Court by a notice of motion for an order granting to said defendant judgment dismissing the amended complaint herein upon the ground that the said complaint does not state facts sufficient to constitute a cause of action, and said motion having come on to be heard before Honorable John C. Knox, one of the Judges of this Court, on the 20th day of July, 1926, in the Court Room of this Court in the old United States Post Office Building, Borough of Manhattan, City of New York, and after hearing Sherwood E. Hall, Esquire, of counsel for the defendant, in support of said motion, and after hearing Henry W. Taft, Esquire, of counsel for the plaintiff, in opposition thereto; and the Court after due deliberation having rendered its opinion on the 5th day of August, 1926, denying said motion on the ground that the said amended complaint states facts sufficient to constitute a cause of action and directing that final judgment should be granted in favor of the plaintiff for the amount de-
[fol. 18] manded in the complaint with interest, and the plaintiff having thereupon duly entered an order in the office of the Clerk of the United States District Court for the Southern District of New York on the 16th day of August, 1926, directing that said motion be denied and that plaintiff might enter judgment against the defendant for the sum of Two thousand forty and 9/100 Dollars ($2,040.09) with interest thereon from the 13th day of June, 1924, together with the costs and disbursements of this action; and the plaintiff having accordingly on the 19th day of August, 1926, served a copy of said order, with notice of entry thereon, upon the attorney for the defendant;

Now, upon motion of Cadwalader, Wickersham & Taft, attorneys for the plaintiff herein, it is

Adjudged that the plaintiff, Elizabeth C. Taft, recover of the defendant, Frank K. Bowers, Collector of United States Internal Revenue for the Second District of the State of New York, the sum of Two thousand forty and 9/100 Dol-

lars ($2,040.09), the amount claimed in the amended complaint herein, together with interest thereon from the 13th day of June, 1924, such interest amounting to Two hundred sixty-seven and 25/100 ($267.25) Dollars; plaintiff's costs having been taxed in the sum of Sixteen and 95/100 Dollars ($16.95); amounting in the whole to the sum of Two thousand three hundred and twenty-four 29/100 Dollars ($2,324.29); and that the plaintiff have execution therefor against the defendant.

August 20, 1926.

Alex. Gilchrist, Jr., Clerk of U. S. District Court for the Southern District of New York.

[fol. 19] In United States District Court

[Title omitted]

Certificate of Probable Cause

The defendant above-named having moved this court by Notice of Motion for an order granting to said defendant judgment dismissing the Amended Complaint herein upon the ground that the said Complaint does not state facts sufficient to constitute a cause of action, and said motion having come on to be heard before this court, and the court having filed its opinion and decision whereby said motion was denied and judgment was directed against the defendant personally, and it appearing that the money which said defendant had received from the plaintiff herein was paid by him into the Treasury of the United States in the performance of his official duty.

Now, therefore, pursuant to Section 989 of the Revised Statutes of the United States, I hereby certify that there was probable cause for the act done by the defendant Collector.

Dated, New York, August 25, 1926.

Jno. C. Knox, U. S. D. J.

[fol. 20] Consented to. Cadwalader, Wickersham & Taft, Attorneys for Plaintiff. Emory R. Buckner, U. S. Attorney, Attorney for Defendant.

IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR WRIT OF ERROR

To the Honorable the Judges of the District Court of the United States for the Southern District of New York.

Now comes Frank K. Bowers, the defendant herein, by his attorney, Emory R. Buckner, United States Attorney for the Southern District of New York, and feeling himself aggrieved by the judgment entered herein on the 20th day of August, 1926, in favor of the plaintiff and against him, by which it was adjudged that the plaintiff have and recover [fol. 21] of the defendant the sum of $2,324.29, and that plaintiff have execution therefor against said defendant, in which judgment and the proceedings had in this cause, certain errors were committed to the prejudice of this defendant, all of which more fully appears in the assignment of errors filed herewith;

Prays that a writ of error may be allowed to him from the United States Circuit Court of Appeals for the Second Circuit to the District Court of the United States for the Southern District of New York, for the correction of the errors so complained of, and that a transcript of the record, proceedings and papers in this cause, duly authenticated, may be sent from said District Court to said Circuit Court of Appeals.

Dated, New York, November 15, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant. Office and Post Office Address: U. S. Courts and P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 22] IN UNITED STATES DISTRICT COURT

[Title omitted]

ASSIGNMENTS OF ERROR

Now comes the above named defendant by his attorney, Emory R. Buckner, United States Attorney for the South-

ern District of New York, and assigns error in the judgment of this Court entered August 20, 1926, in the following respects:

1. The Court erred in holding and deciding that the amended complaint stated facts sufficient to constitute a cause of action.

2. The Court erred in failing to hold that the amended complaint did not state facts sufficient to constitute a cause of action.

3. The Court erred in granting plaintiff's motion for judgment.

4. The Court erred in failing to deny plaintiff's motion for judgment.

5. The Court erred in directing the entry of judgment in favor of the plaintiff and against the defendant for the sum [fol. 23] of $2,040.09, interest and costs, a total of $2,324.29.

6. The Court erred in directing the entry of judgment in favor of the plaintiff and against the defendant.

7. The Court erred in failing to dismiss the amended complaint.

8. The Court erred in failing to direct the entry of judgment in favor of the defendant and against the plaintiff, dismissing the amended complaint.

Wherefore defendant prays that said judgment of the District Court be reversed.

Dated, New York, November 15, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant. Address and Post Office Address: U. S. Court & P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 24] Citation, in usual form, omitted in printing.

[fol. 25] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION RE TRANSCRIPT OF RECORD

It is hereby stipulated and agreed, that the foregoing is a true transcript of the record of the said District Court in the above entitled matter as agreed on by the parties.

Dated, December 6th, 1926.

Cadwalader, Wickersham & Taft, Attorneys for Plaintiff. Emory R. Buckner, U. S. Attorney, Attorney for Defendant.

[fol. 26] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 27] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1926

Nos. 280-294

Argued May 20, 1927. Decided July 5, 1927

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York, Plaintiff in Error (Defendant Below),

v.

ELIZABETH C. TAFT, Defendant in Error (Plaintiff Below)

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York, Plaintiff in Error (Defendant Below),

v.

GILBERT C. GREENWAY, JR., Defendant in Error (Plaintiff Below)

In Error to the District Court of the United States for the Southern District of New York

Before Manton, L. Hand, and Swan, Circuit Judges

OPINION

In Error to the District Court of the United States for the Southern District of New York.

Actions by Elizabeth C. Taft and by Gilbert C. Greenway, Jr., against Frank K. Bowers, Collector of Internal Revenue, to recover for income taxes paid under protest. Judgments for plaintiffs; defendant appeals. Reversed.

Charles H. Tuttle, U. S. Atty., of New York City (Samuel C. Coleman, Asst. U. S. Atty., of New York City, of counsel), for plaintiff in error.

Cadwalader, Wickersham & Taft, of New York City (Henry W. Taft and Clarence Castimore, both of New York City, of counsel), for defendant in error Taft.

Baldwin, Hutchins & Todd, of New York City (Robert A. Young and E. Raymond Shepard, both of New York City, of counsel), for defendant in error Greenway.

MANTON, Circuit Judge:

These cases were argued together and will be considered in one opinion. The defendant in error Miss Taft received a gift from her father of 150 shares of the common stock of the Nash Motors Company—100 shares in December, 1921, and 50 shares in March, 1922. They were transferred on the books of the corporation in her name on December 26, 1922, when she became the record owner thereof. They were obtained by her father as a bonus in connection with the purchase of preferred stock of the Nash Motors Company. In February, 1923, the Nash Motors Company declared a stock dividend of four shares of common and three [fol. 28] shares of preferred on each share of common stock to the stockholders of record on December 26, 1922. As a result she became the owner of 750 shares of common and 450 shares of preferred stock. After the receipt of this stock, in 1923, she sold 200 shares of common and 130 shares of preferred stock for $34,345.30. The market value of her 150 shares of common at the time she received the gift from her father was $42,350. The stock which she sold in 1923 brought $11,708 more than it was worth when she received it. In making her income tax return and paying the same for 1923, she included the entire gain of the sale of the stock sold by her as income for that year. This was required by section 202 (a) of the Revenue Act of 1921 (Comp. St. § 6336⅛bb). She paid a tax upon the basis of the original return, and thereafter protested against the tax upon the

full amount of the proceeds, arguing that she should have been required to account, as income, for the difference between the value of the stock when she acquired it and the price at which she had sold it, to wit, $11,708.80.

In Mr. Greenway's case, the action is to recover a tax paid under protest as income tax for the year 1922, payment being made in 1923. The stock sold by this defendant in error was also a gift made by his brother to him. The stock was likewise sold at a profit.

The statute involved, section 202 (a) (2) of the Revenue Act of 1921, provides:

"(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

"(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

A profit resulting from the conversion of capital assets is income, within the Sixteenth Amendment of the Constitution. Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509, 41 S. Ct. 386, 65 L. Ed. 751, 15 A. L. R. 1305; Eldorado Coal & Mining Co. v. Mager, 255 U. S. 522, 41 S. Ct. 390, 65 L. Ed. 757; Walsh v. Brewster, 255 U. S. 536, 41 S. Ct. 392, 65 L. Ed. 762. Income from gifts is treated in the same manner as income from other sources, and income has been defined as gain derived from capital and labor or from both combined provided it be understood to include profit or gain through a sale or conversion of capital assets.

Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. The statute here attacked recognized this definition of income, and measures the profit or loss upon the sale or conversion of the gift as a difference between the price which the donor paid for it and the price which the donee obtained. The value of the property at the time the donor transferred it to the donee is ignored and Congress, in effect, charged the gift with the tax which the donor would have paid had he received the market value for it at the time of the gift.

The arguments of the defendants in error are that a gift is in the nature of capital assets, and that no tax is imposed upon the gift as such. The arguments further are that, by taxing as income the difference between the cost to the donor and the price, realized by the donee, the tax is being imposed upon the corpus of the gifts themselves, and that section 213 (b) of the statute (Comp. St. § 6336⅛ff), forbids this. But the question is whether the method adopted by Congress for measuring income is, in the case of the donee, a reasonable one in the aid of the purposes of federal income taxation. Section 213 (b) does not define what is income from a gift. The defendants in error accede to the position that what each received when they sold the property, if it shows an increase, is a profit; but, in measuring it, the price at the date each received the gift must be assumed to be its worth to them. But Congress has measured otherwise, and it says, in protecting the government against loss of revenue, it is proper that where the donee pays nothing, it accepts as a measure of gain or loss the cost to the donor without reference to its actual value when received by the donee.

[fol. 29] The obvious purpose of section 202 (a) (2) was to prevent the loss of income represented within the profit to the donor during the period he held the property before he made his gift. Congress has determined that this same increment shall be recognized as income, even though a gift intervenes. The transfer by gift is but a change of ownership in the specific property. In doing this, Congress imposes no tax upon an unrealized gain. The value of the property is ignored or not taken into account until the property is finally disposed of in such a way that it could be determined that the owner made either a gain or a loss,

and, until there is a sale, there is no necessity for measuring income, nor is there an opportunity to do so. This avoids tax evasion or tax avoidance. This statute puts the donee, who pays nothing for the property, and who therefore loses nothing, on any theory of economic principle, in the position the donor would have been, in so far as taxation is concerned.

Nor does this method of taxation suggest that the statute is unconstitutional, as in violation of the Fifth Amendment. While the power to tax is not absolute, a tax should be shown to be arbitrary and capricious before it is condemned. The power of Congress to tax as permitted under the Sixteenth Amendment must be recognized, as well as protection under the Fifth Amendment. The method of the statute which regards the corpus of the gift, irrespective of its value, as a thing which is transferred, is essential to the entire taxing scheme. The method results in no greater tax than that which would have been imposed upon the donor and the donee, if each had been asked to pay a proportion of the tax based upon the amount of the increment when in the hands of each. Only the income from the gift is affected by the statute. It is not the donee's income from other sources. The statute is prospective in operation, and relates to gifts made after a certain date. A donee must, therefore, be charged with the knowledge that under the law the gift may be worth less to him because of the necessity of sharing part of the profits with the government—that part which had accumulated up to the time he had received the gift. The argument against the constitutionality of the section loses sight of the fact that the statute is directed toward a means for collecting the revenue which is made available under the income tax statute. Knowlton v. Moore, 178 U. S. 41, 20 S. Ct. 747, 44 L. Ed. 969; N. Y. Trust Co. v. Eisner, 256 U. S. 345, 41 S. Ct. 506, 65 L. Ed. 963, 16 A. L. R. 660.

The statute may, indeed, be said to be an execution of the main design of the Income Tax Act. That it is proper to ignore the value of property at the time of the gift is illustrated by the excess profits tax. A tax upon a donor for making a gift is not in violation of the Constitution. Anderson v. McNeir, 16 F. (2d) 970.

The Supreme Court said, in La. Belle Iron Works v. United States, 256 U. S. 377, 41 S. Ct. 528, 65 L. Ed.

998: "Nor can we regard the act—in basing 'invested capital' upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due process clause of the Fifth Amendment. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the states under the equal protection clause, much less of Congress under the more general requirement of due process of law in taxation. Of course, it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion, within the bounds of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation."

So here Congress, in effect, has said that, notwithstanding the value of the property, from an economic standpoint, for the purpose of this taxation, that value is ignored, and only the value when the property was acquired by the donor is considered. This is deemed necessary to the enforcement of this aspect of the Income Tax Law, where a gift is made, and where a profit or loss is afterwards realized, and it becomes necessary to make proper measurement thereof. Although popularly the gift has a fixed value at the date of transfer, there is no constitutional objection, for income tax purposes, in rejecting or in ignoring that fact, and holding that the rights transferred by the gift, which include the increment while in the hands of the donor, are subject to the tax. No one would have doubted the power of Congress to impose a tax upon the donor at the time of the gift, and the tax could have been measured by the difference between the price he paid for it and its value when [fol. 30] he transferred it. Nor could it be criticized if the donee was left to pay the balance of the tax, based upon the difference between the value on the date of acquisition and the value on the date of sale.

The statute does no more than tax the donee for a gift when he sells it, and measures that income for income tax purposes as based upon the difference between the cost when acquired by the donor and the price realized by the donee. It is not capricious to put property acquired by

gift in a special class, and to tax it differently from property acquired by purchase. Bowman v. Cont. Oil Co., 256 U. S. 642, 41 S. Ct. 606, 65 L. Ed. 1139; Brushaber v. Union Pac. R. R. Co., 240 U. S. 1, 36 S. Ct. 236, 60 L. Ed. 493; Thomas v. U. S., 192 U. S. 363, 24 S. Ct. 305, 48 L. Ed. 481. It is sufficient, for the main purposes of the Sixteenth Amendment and the income tax enactments pursuant thereto, if the method of taxation is consistent with the entire scheme of taxation and the tax imposed by that method may not be considered direct.

We think that Congress, in levying the tax here, was well within its constitutional power in creating a classification which was reasonable, and neither the tax nor the method of enforcing it was arbitrary or capricious. Barclay & Co. v. Edwards, 267 U. S. 442, 45 S. Ct. 135, 348, 69 L. Ed. 703.

The judgments below are reversed, with costs.

Swan, Circuit Judge, dissents.

[fol. 31] In United States Circuit Court of Appeals

[Title omitted]

Concurring Opinion

L. Hand, Circuit Judge (concurring):

In each of these cases the amount of the tax does not exceed the increase in value of the gift while in the donee's hands. Strictly speaking, the question does not therefore arise whether Congress may, as a tax on income, seize any part of the increase in value of the gift before the donee accepted it. I am not entirely sure that a tax, if limited to the increase in the donee's hands, might not be calculated upon the difference between what the donor paid and the donee got. At the argument, I was disposed to think that these cases might be decided on some such reasoning, but it is pretty clear that that would make a new statute. Congress did not mean so to limit the tax. In the first place the results would be so capricious that the validity of the law might be doubtful, and in the second, much revenue would be lost which was certainly intended to be reached. We

may hardly so far strain the law to save it. So I think that this act must be good in whole or not at all.

No increase in value not realized in cash can be taxed as income under the Sixteenth Amendment; that was very deliberately decided in Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. If so, it is impossible to tax the increase in the donor's hands at all; it is not income, though at any time by a sale he could have made it such. The same increase is as little income, even after it has passed to the donee, until he sells. However, it [fol. 32] seems to me equally clear that when he does, there has been a gain which is in every sense income, to the extent of the difference between what the donor paid and the donee got. I am not concerned for the moment with whose gain it is, but that the whole gain is income cannot, I submit, be disputed. If it is important, I suggest that the language of the Amendment itself gives Congress power to lay "taxes on incomes," not on persons. Therefore there is a subject-matter which Congress may tax without apportionment, and part of which, after Eisner v. Macomber, it could not tax in any other way, except perhaps as an excise.

I can see no injustice in regarding the whole of this gain as income of the donee, and if there be no injustice certainly it is not within the Fifth Amendment. Suppose that the law charged the corpus of the gift while in the donor's hands with an inchoate tax at specified rates, to be calculated upon its increase whenever it was sold. The donee in accepting such a gift would take it subject to that charge, though its amount would remain undetermined until he sold. I can see nothing unconstitutional in that, nor in imposing upon him a corresponding duty in personam because of his acceptance. So far as that would involve uncertainty, arising from fluctuation in value of the gift after acceptance, it would be entirely within the donee's control, for he may sell when he likes, and could scarcely complain of any increase which might result from his delay. It is true that Congress has gone further than that, because it has made the whole gain a part of his income for the year in which he sells. But again so far as that is dependent upon the amount of his other income, he can reckon with it when he accepts the gift, and of any subsequent fluctuation he takes

his chance, precisely as he does of fluctuation in the value of the gift.

Therefore I fail to see any oppression in this method of calculating the tax upon what, as I have said, appears to me an unquestionable subject-matter for taxation. In Lynch v. Turrish, 247 U. S. 221, 38 S. Ct. 537, 62 L. Ed. 1087, the gain had accrued before the amendment went into effect. I read Gray v. Darlington, 15 Wall. 63, 21 L. Ed. 45, in the same sense, though perhaps it was only a forerunner of Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. People ex rel. Brewster v. Wendell, 196 App. Div. 613, 188 N. Y. S. 510, dealt with a statute which sought to tax the donor, and was void where Eisner v. Macomber is law. That the statute is reasonably ancillary to a valid constitutional purpose seems to me as plain as in Rice v. Eisner, 16 F. (2d) 358 (C. C. A. 2); that the practice, if permissible, will become a common contrivance to frustrate that purpose, I have no doubt whatever.

I concur with my brother Manton.

[fol. 33] In United States Circuit Court of Appeals

[Title omitted]

Dissenting Opinion

Swan, Circuit Judge (dissenting):

I am unable to agree with the result reached by my colleagues. Section 202 (a) (2) of the Revenue Act of 1921 attempts to include as income of the donee, sustained upon sale of the gift, the increment in value which accrued during the time the property was owned by the donor, or by his predecessor in title if the donor himself received it as a gift. It has been established that Congress may not tax as income what in fact is not income, without apportioning the tax according to the constitutional requirement. Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. Property obtained by gift is capital, not income in the hands of the donee upon its receipt. Edwards v. Cuba Railroad, 268 U. S. 628, 45 S. Ct. 614, 69 L. Ed.

1124; United States v. Oregon-Washington, etc., Co., 251 F. 211 (C. C. A. 2). This is expressly recognized by the declaration of sections 213 (b) (3) of the Revenue Act of 1921 to the effect that gross income shall not include the value of property acquired by gift, but only the income from such property. But section 202 defines the income from such property as including the increment in value which [fol. 34] accrued before the donee became owner of the property. This is an attempt to declare to be income of the donee, when realized by sale of the gift, something which was part of the donee's capital before the sale.

In Doyle v. Mitchell Bros. Co., 247 U. S. 179, 38 S. Ct. 467, 62 L. Ed. 1054, Mr. Justice Pitney, speaking for a unanimous court, said: "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration." It was held that, where the increase in capital value occurred before passage of the taxing act, such increase is not taxable as income upon sale of the property. A similar decision as to the Income Tax Act of 1913 (38 Stat. 114) appears in Lynch v. Turrish, 247 U. S. 221, 38 S. Ct. 537, 62 L. Ed. 1087.

I am unable to see why these cases are not applicable. The period under consideration in determining the gain realized by the taxpayer donee is the period of the donee's ownership. Only by giving an unreal valuation to the capital of the donee, namely, the cost of the gift to the donor or his predecessor in title, is it possible to consider the total gain above such cost as income to the donee realized by his sale. It does not seem to me a sufficient answer to say that the donee accepts the gift with knowledge that Congress has declared it to have this fictitious valuation for income tax purposes. The tax is not an excise on the privilege of accepting the gift; it is an income tax, and the tax payer's income must be a gain derived from his capital, or his labor, or from both combined.

It is my opinion, therefore, that the judgments should be affirmed.

[fol. 35] In United States Circuit Court of Appeals

[Title omitted]

Decree—Filed July 13, 1927

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed with costs. Further ordered that execution be issued for the collection of said costs.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

M. T. M. L. H.

[fol. 36] [File endorsement omitted.]

[fol. 37] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 38] Supreme Court of the United States

Order Allowing Certiorari—Filed November 21, 1927

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Chief Justice Taft took no part in the consideration or decision of the petition for writ of certiorari in this case.

CLERK'S COPY.

TRANSCRIPT OF RECORD

20

Supreme Court of the United States

OCTOBER TERM, 1927 8

No. ~~575~~ 17

GILBERT C. GREENWAY, JR., PETITIONER,

vs.

FRANK K. BOWERS, COLLECTOR OF UNITED STATES INTERNAL REVENUE FOR THE SECOND DISTRICT OF THE STATE OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 3, 1927

CERTIORARI GRANTED NOVEMBER 21, 1927

(33,027)

(33,027)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927

No. 575

GILBERT C. GREENWAY, JR., PETITIONER,

vs.

FRANK K. BOWERS, COLLECTOR OF UNITED STATES INTERNAL REVENUE FOR THE SECOND DISTRICT OF THE STATE OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

INDEX

	Original	Print
Record from the district court of the United States, southern New York	1	1
Writ of error	1	1
Summons	3	2
Complaint	4	3
Exhibits "A" to "D"—Correspondence between collector of internal revenue and Baldwin, Hutchins & Todd	10	6
Exhibit "E"—Claim for refund of taxes	13	9
Exhibit "F"—Letter to G. C. Greenway, Jr., rejecting claim for refund of taxes	15	10
Motion to dismiss and notice thereof	17	11
Opinion, Knox, J	19	12
Order denying motion to dismiss	22	13
Judgment	23	14
Certificate of probable cause	25	15

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., DECEMBER 5, 1927

	Original	Print
Petition for writ of error	27	16
Assignments of error	28	17
Citation (omitted in printing)	30	
Stipulation re transcript of record	31	18
Clerk's certificate (omitted in printing)	32	
Proceedings in the United States circuit court of appeals, second circuit	33	19
Opinion, Manton, J.	33	19
Concurring opinion, Hand, J.	37	25
Dissenting opinion, Swan, J.	39	27
Decree	41	28
Clerk's certificate (omitted in printing)	43	
Order allowing certiorari	44	29

[fols. a & 1]

IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

Writ of Error

United States of America, ss:

The President of the United States of America to the Judges of the District Court of the United States for the Southern District of New York, Greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the District Court, before you, or some of you, between Gilbert C. Greenway, Jr., Plaintiff, and Frank K. Bowers, Collector of United States Internal Revenue for the Second District of the State of New York.

A manifest error hath happened to the great damage of the said Frank K. Bowers, Collector of United States Internal Revenue for the Second District of the State of New York, as is said and appears by the complaint. We being willing that such error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the Judges of the United States Circuit Court of Appeals for the Second Circuit, at the City of New York, together with this writ, so that you have the same at the said place, before the Judges aforesaid, on the 16th day of December, 1926, that the record and proceedings aforesaid being inspected, the said Judges of the [fol. 2] United States Circuit Court of Appeals for the Second Circuit may cause further to be done therein, to correct that error, what of right and according to the law and custom of the United States ought to be done.

Witness, the Honorable William H. Taft, Chief Justice of the United States, this 17th day of November, in the year of our Lord one thousand nine hundred and twenty-

six, and of the Independence of the United States the one hundred and fifty-first.

Alex Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, in the Second Circuit.

The foregoing writ is hereby allowed. Henry W. Goddard, U. S. District Judge.

[fol. 3] IN UNITED STATES DISTRICT COURT

GILBERT C. GREENWAY, JR.,

against

FRANK K. BOWERS, Collector of United States Internal Revenue for the Second District of the State of New York

SUMMONS

To the above-named defendant:

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer, or, if the complaint is not served with this summons, to serve a notice of appearance, on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service. In case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Witness, the Honorable, Augustus N. Hand, Judge of the District Court of the United States for the Southern District of New York, at the City of New York, this 26th day of May, A. D. 1926.

Alex. Gilchrist, Jr., Clerk. Baldwin, Hutchins & Todd, Plaintiff's Attorneys.

Office and Post Office Address: 120 Broadway, Borough of Manhattan, City of New York.

[fol. 4] IN UNITED STATES DISTRICT COURT

[Title omitted]

COMPLAINT

Plaintiff by his attorneys, Baldwin, Hutchins & Todd, complaining of the defendant respectfully shows to this court:

First. That at all times hereinafter mentioned, plaintiff was and now is a citizen of the United States and a resident of the City, County and State of New York, in said Southern District of New York.

Second. Upon information and belief that the above named defendant is a citizen of the United States, and a resident of the Borough of Manhattan, City, County and State of New York, and was on the 15th day of March, 1923, and has been at all times since said date the Collector of the United States Internal Revenue for the Southern District of New York.

Third. That during the years 1921 and 1922, one John C. Greenway, plaintiff's brother, was the owner of 10,000 [fol. 5] shares of the capital stock of Ahumada Lead Company, a corporation organized under the laws of the State of Delaware, for which he had paid the sum of $1.00 per share, or a total of $10,000.

Fourth. That on or about the 29th day of March, 1921, said John C. Greenway gave and delivered to the plaintiff, without the payment of any consideration therefor 5000 shares of said stock; that the market value of said 5,000 shares of stock on said day was $13,750.

Fifth. That on or about the 1st day of March, 1922, said John C. Greeway, gave and delivered to the plaintiff, without the payment of any consideration therefor the remaining 5000 shares of said stock; that the market value of said 5000 shares of stock on said day was $16,250.

Sixth. That thereafter and on about the 1st day of August, 1922, plaintiff sold the said 10,000 shares of stock for the sum of $52,500, which amount was the then market value thereof.

Seventh. That on or about March 15, 1923, plaintiff duly made and filed with the defendant his return of income received during the year ending December 31, 1922, in which he reported that he had received a profit on the sale of said 10,000 shares of said Ahumada Lead Company stock of $42,500. In a note attached to said return plaintiff stated in reference to said stock "this stock was received as a gift in 1921-22; sold for $5.25 per share, cost donor $1.00 per share.

Eighth. That plaintiff reported in said return that his [fol. 6] net income for the year ending December 31, 1922, was $57,514.56, which included said sum of $42,500 reported as a profit from the sale of said 10,000 shares of said Ahumada Lead Company stock, and based thereon plaintiff paid to the defendant pursuant to Title I and Title II of the Act of Congress known as the Revenue Act of 1921" an income tax of $11,120.31 in four instalments on March 15, 1923, June 12, 1923, September 14, 1923, and December 15, 1923, respectively.

Ninth. That had the profit received by the plaintiff on the sale of said stock been reported in said return at $22,500, viz: the difference between the value of said stock when plaintiff acquired the same and the mount for which he sold the same, instead of at $42,500, as stated in said return, plaintiff's net taxable income for the ending December 31st, 1922, would have been reduced by $20,000, and the tax due thereon would have been $4,441.61 less than the tax paid by the plaintiff as heretofore alleged.

Tenth. That plaintiff reported his profit on the sale of said stock in said return at $42,500, instead of a $22,500, solely in obedience to the provisions of Section 202 (a) (2) of said Revenue Act of 1921, which provides that the basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property acquired by gift after December 31, 1920, shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift.

Eleventh. That so much of said tax paid by the plaintiff as heretofore alleged as is based on the item of $42,500 re- [fol. 7] ported by plaintiff in his said return as a profit on the sale of said stock was paid to defendant under protest

and in order to avoid the penalties imposed by law for non-payment. Said protests were in writing in the form of letters written by Baldwin, Hutchins & Todd, plaintiff's attorneys, to the Collector of Internal Revenue for the Second District of New York, the defendant herein, and were filed with said defendant at the time said tax instalments were paid. Copies of said letters are hereto annexed marked Exhibits "A", "B", "C" and "D" respectively.

Twelfth. That the levy and collection on the part of the Treasury Department of the United States and the defendant herein of an income tax against the plaintiff on the sum of $20,000, namely, the difference between the cost to said John C. Greenway, plaintiff's brother, of said 10,000 shares of capital stock of said Ahumada Lead Company, and the value of said stock at the time the same was given to the plaintiff, by said John C. Greenway, is an attempt to levy a direct tax upon the capital or property of the plaintiff, but without apportionment among the States in proportion to the population as required by Sub-Division 4, Section 9 of Article I of the Constitution of the United States. That the levy of a tax on the said sum of $20,000 is an attempt to tax as income that which was in fact capital or property of the plaintiff and not income within the provisions of Article XVI of the Constitution of the United States.

Thirteenth. That said Section 202 (a) (2) of the said Act of Congress known as "Revenue Act of 1921" in so far as it provides that, for the purpose of ascertaining the amount of gross income from which the amount of net income sub-
[fol. 8] ject to tax is to be computed, the basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property acquired by gift after December 31, 1920, shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift, is contrary to and in violation of the provisions of Sub-Division 4, Section 9 of Article I, and of Article XVI, of the Amendments to the Constitution of the United States, and, therefore, void and unenforceable.

Fourteenth. That on or about the 27th day of March, 1924, plaintiff duly made and filed with the defendant a written claim for refund of taxes, a copy of which is hereto

annexed marked Exhibit "E" wherein and whereby plaintiff demanded that the said amount of $4,441.61 be refunded and paid back to the plaintiff as a tax illegally and improperly assessed and collected.

Fifteenth. That thereafter and on or about the 15th day of December, 1924, said claim for refund of said tax was duly rejected in writing, a copy of which rejection is hereto annexed and marked Exhibit "F".

Sixteenth. That no part of said illegal tax of $4,441.61 has been refunded or repaid to plaintiff although same has been duly demanded.

Seventeenth. That this is a suit of civil nature at common law and arises under the Constitution and Laws of the United States and under the laws of the United States providing for Internal Revenue.

[fol. 9] Wherefore, plaintiff demands judgment against the defendant in the sum of $4,441.61, with interest thereon from December 15, 1923, together with the costs and disbursements of this action.

Baldwin, Hutchins & Todd, Attorneys for Plaintiff.

Office and Post Office Address: 120 Broadway, Borough of Manhattan, New York City.

Duly sworn to by Gilbert C. Greenway, Jr. Jurat omitted in printing.

[fol. 10] EXHIBIT A TO COMPLAINT

March 15, 1923.

Collector of Internal Revenue, 2nd District, Custom House, New York City, N. Y.

DEAR SIR: We are handing you herewith personal income tax return of Mr. Gilbert C. Greenway, Jr., of 61 Broadway, together with Mr. Greenway's check for $2,780.08, representing one-quarter of the amount of income — shown by such return.

Mr. Greenway has included as income in his return an item of $42,500 profit, as representing the difference between the cost to the donor and the price at which he sold 10,000 shares of capital stock of the Ahumada Lead Company which was given to him as a gift during the year 1921-1922. This amount of profit is included as income under protest and the tax thereon is paid under protest, reserving to Mr. Greenway the right to take such action as he may consider proper to recover the amount of tax paid upon such alleged profit.

Will you kindly stamp the enclosed duplicate copy of this letter so that we will have evidence that it was received by you?

Yours very truly, (Signed) Baldwin, Hutchins & Todd.

RAY:C.
Enclosures.

[fol. 11] EXHIBIT B TO COMPLAINT

June 12, 1923.

Collector of Internal Revenue, 2nd District, Custom House, New York City, N. Y.

DEAR SIR: We are handing you herewith check of Gilbert C. Greenway for the second installment of his income tax for the year 1922.

This payment is made under the same protest as accompanied the payment of the first installment of this tax on March 15, 1923.

Will you kindly stamp this letter, showing its receipt by you and return the same for our files?

Yours very truly, (Signed) Baldwin, Hutchins & Todd.

RAY:C.
Enclosure.

EXHIBIT C TO COMPLAINT

September 14, 1923.

Collector of Internal Revenue, 2nd District, Custom House, New York City, N. Y.

DEAR SIR: We are enclosing herewith check of G. C. Greenway, Jr., in payment of the third installment of his income tax for the year 1922.

[fol. 12] This payment is made under protest, reserving the right of Mr. Greenway to file a claim and sue for the refund of all or any part of such payment.

Very truly years, (Signed) Baldwin, Hutchins & Todd.

RAY:C.
Enclosure.

EXHIBIT D TO COMPLAINT

December 15, 1923.

Collector of Internal Revenue, 2nd District, Custom House, New York, N. Y.

DEAR SIR: We are handing you herewith check for $2,780 of Gilbert C. Greenway, being the final installment of his income tax for the year 1922.

This payment is made under the same protest as accompanied the first installment of this tax on March 15, 1923.

Will you kindly stamp this letter showing its receipt by you and return the same for our files?

Yours very truly, Baldwin, Hutchins & Todd.

Y. C.
Enclosure.

[fol. 13] EXHIBIT E TO COMPLAINT

Claim for Refund of Taxes Illegally Collected

STATE OF NEW YORK,
County of New York, ss:

Gilbert C. Greenway, Jr., 61 Broadway, New York, N. Y.

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below with reference to said statement are true and complete:

Period: Year. From: 1/1/22. To: 12/31/22.
1. Business in which engaged: Broker.
2. Character of assessment or tax: ——.
3. Amount of assessment or stamps purchased: ——.
4. Reduction of Tax Liability requested (Income and Probits Tax): $——.
5. Amount to be abated: $——.
6. Amount to be refunded (or such greater amount as is legally refundable): $4,441.61.
7. Dates of payment (see Collector's receipts or indorsements of canceled checks): Total tax paid for the year 1922, $11,120.31, paid quarterly.

[fol. 14] (If statement covers income tax liability, items 8-11, inclusive, must be answered.)

8. District in which return (if any) was filed: 2nd, New York, N. Y.
9. District in which unpaid assessment appears: ——.
10. Amount of overpayment claimed as credit: $——.
11. Unpaid assessment against which credit is asked; period from —— —, ——, to —— —, ——, $——.

Deponent verily believes that this application should be allowed for the following reasons:

During the year 1921-1922, the taxpayer received as a gift 10,000 shares of Ahumada Lead Company stock. 5,000 shares were received in 1921 at a time when the market value of such stock was 2¾ per share and 5,000 shares were received in 1922 when the market value of the stock was 3¼ per share. The entire 10,000 shares were sold in 1922

for $52,500, or at 5¼ per share. The original cost of the stock to the donor was $1.00 per share and under the provisions of the Revenue Act of 1921, the taxpayer was required to report a total profit of $42,500, whereas his actual profit, based upon the difference in the value at the time of acquisition and the time of sale was $22,500. He, therefore, paid tax on a fictitious profit of $20,000.00, which makes a difference in his total tax for the year of $4,441.61. This tax was paid under protest. The taxpayer claims that the provisions of Section 202, Subdivision 2 of Para- [fol. 15] graph A are unconstitutional and invalid and for this reason requests the refund of the difference between the amount paid and the amount which would have been paid but for this provision of the law.

Gilbert C. Greenway, Jr.

Sworn to and subscribed before me this 26th day of March, 1924. Mary E. Steers, Notary Public, Bronx County. Bronx Co. Clk. No. 202, Reg. No. 527. N. Y. Co. Clk. No. 1259, Reg. No. 5084. Term expires March 30, 1925. (Seal.)

EXHIBIT F TO COMPLAINT

Treasury Department, Washington, Office of Commissioner of Internal Revenue

IT:PA:2. CRY-205. December 15, 1924.

Mr. Gilbert C. Greenway, Jr., 61 Broadway, New York, N. Y.

SIR: Your claim for refund of $4,441.61, individual income tax for the year 1922, has been examined.

[fol. 16] The claim is based upon the statement that the profit on certain stock, received by you as a gift, should be the difference between the selling price and the market value of such stock when received by you, rather than the difference between the selling price and the cost of the donor.

You are advised that Section 202 (a) (2), Regulations 62, reads in part as follows:

"In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor of the last preceding owner by whom it was not acquired by gift."

Your claim will, therefore, be rejected.

The rejection of your claim will officially appear upon the next schedule to be approved by the Commissioner.

Respectfully, (Signed) J. G. Bright, Deputy Commissioner by A. Lewis, Head of Division.

[fol. 17] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION TO DISMISS AND NOTICE THEREOF

Now comes the above named defendant by his attorney Emory R. Buckner, United States Attorney for the Southern District of New York and moves to dismiss the complaint herein upon the ground that the said complaint does not state facts sufficient to constitute a cause of action.

Dated New York, June 17, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant.

Office & P. O. Address: U. S. Courts & P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 18] [Title omitted]

SIR: Please take notice that the motion to dismiss the complaint herein upon the ground that the said complaint does not state facts sufficient to constitute a cause of action, made up and on behalf of the defendant under date of June 17, 1926, will be brought on for hearing at a term of the United States District Court for the Southern District of New York at the Old Post Office Building, in the Borough of Manhattan, City of New York, on the 20th day of July,

1926, at 10:30 A. M. or as soon thereafter as counsel can be heard.

Dated New York, June 25, 1926.

Yours, etc., Emory R. Buckner, United States Attorney for the Southern District of New York., Attorney for Defendant.

Office & P. O. Address: U. S. Courts P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 19] To Baldwin, Hutchins & Todd, Esqs., Attorneys for Plaintiff, 120 Broadway, Borough of Manhattan, City of New York.

IN UNITED STATES DISTRICT COURT

[Title omitted]

OPINION

[fol. 20] KNOX, D. J.:

It is my opinion that no part or portion of the value of an outright bona fide gift as of the date of delivery is, or can, constitute taxable income in the hands of the donee. So far as the latter is concerned, the gift is a capital transaction. His liability for future income therefrom must be based on the value of the gift as of the time the transaction is complete, and not upon the cost of the property at the date of its acquisition by the donor. If the construction of the tax law, for which the Government contends, should be applied, it means that the donee of property is to be taxed upon an increment in value which, it if can be regarded as income at all, is income to another, viz: the donor. A tax levied upon that increment in the hands of the donee necessarily results in a direct levy upon the gift. If the gift consisted of money, would it be argued that the donee is to be taxed on the difference in value of the money, that is, its purchasing power, as between the date of its acquisition by the donor, and the date of its delivery to the donee? I think not. The money would be regarded as capital in the hands of the donee; and so, I think that that which may

be converted into money, as of the date upon which it is given away, must, so far as the donee is concerned, also be regarded as capital.

[fol. 21] According to my views, the 16th Amendment to the Constitution conferred no power upon the Congress to tax gifts.

Very likely, it is possible to devise reasonably plausible arguments to the effect that what is transferred by the donor is nothing more than his original investment therein, and to cite various decisions which contain expressions that may be tortured to support the argument; but the fact remains that the common understanding of a gift is that the donee acquires, absolutely and completely, the entire value of the donation as of the date of transfer. Until a higher court than this is willing to endorse a different principle, I certainly shall not do so.

The motion to dismiss the complaint is denied and the plaintiffs may have judgment for the claim asserted against the Collector. He, of course, will be granted a certificate.

August 5, 1926.

Jno. C. Knox, U. S. D. J.

[fol. 22] In United States District Court

[Title omitted]

Order Denying Motion to Dismiss

The defendant above-named, having moved this court by notice of motion dated the 17th day of June, 1926, for an order granting defendant judgment dismissing the complaint upon the ground that said complaint does not state facts sufficient to constitute a cause of action, and said motion having regularly come on to be heard before Honorable John C. Knox, one of the Judges of this court, on the 20th day of July, 1926, in the Court Room of this court in the old United States Post Office Building, Borough of Manhattan, City of New York, and after hearing Sherwood E. Hall, Esq., of counsel for defendant in support of said motion, and after hearing E. Raymond Shepard, Esq., of counsel for plaintiff in opposition thereto, and the court after due

deliberation having rendered its opinion on the 5th day of August, 1926, that the said complaint states facts sufficient to constitute a cause of action;

Now, upon reading said notice of motion and said complaint, and upon said opinion of this court, all of which [fol. 23] have been filed heretofore with this court, and upon motion of Baldwin, Hutchins & Todd, attorneys for plaintiff, it is

Ordered that said motion to dismiss the complaint be and the same is hereby in all respects denied, and it is further

Ordered that plaintiff may enter judgment against defendant for the sum of Four thousand four hundred forty-one and 61/100 ($4,441.61) with interest thereon from the 15th day of December, 1923, together with the costs and disbursements of this action.

Jno. C. Knox, U. S. D. J.

AGJ.

In United States District Court

[Title omitted]

Judgment

The defendant above named, having moved this Court by notice of motion dated the 17th day of June, 1926, for an order granting defendant judgment dismissing the com- [fol. 24] plaint upon the ground that said complaint does not state facts sufficient to constitute a cause of action, and said motion having regularly come on to be heard before Honorable John C. Knox, one of the Judges of this Court on the 20th day of July, 1926, in the Court Room of this Court in the old United States Post Office Building, Borough of Manhattan, City of New York, and after hearing Sherwood E. Hall, Esq., of counsel for defendant in support of said motion, and after hearing E. Raymond Shepard, Esq., of counsel for defendant, in opposition thereto, and the Court after due deliberation having rendered its opinion on the 5th day of August, 1926, denying said motion on the ground that said complaint states facts sufficient to constitute a cause of action and directing that final judgment should be granted in favor of plaintiff for

the amount demanded in the complaint, with interest, and plaintiff having thereupon duly entered an order in the office of the Clerk of the United States District Court for the Southern District of New York on the 2nd day of September, 1926, directing that said motion be denied, and that plaintiff might enter judgment against defendant for the sum of Four Thousand four hundred forty-one and 61/100 ($4,441.61) Dollars, with interest thereon from the 15th day of December, 1923, together with costs and disbursements of this action, and plaintiff having accordingly on the 11th day of September, 1926, served a copy of said order with notice of entry thereof upon the attorney for defendant.

Now, upon motion of Baldwin, Hutchins & Todd, attorneys for plaintiff, it is

Adjudged that plaintiff Gilbert C. Greenway, Jr., recover of defendant Frank K. Bowers, Collector of United [fol. 25] States Internal Revenue for the Second District of the State of New York, the sum of Four thousand four hundred forty-one and 61/100 ($4,441.61), the amount claimed in the complaint, together with interest thereon from the 15th day of December, 1923, such interest amounting to $727.21, plaintiff's costs having been taxed in the sum of $20.00, amounting in the whole to the sum of five thousand, one hundred eighty-eight and 82/100 ($5,188.82) Dollars and that plaintiff have execution therefor against defendant.

Alex. Gilchrist, Jr., Clerk United States District Court, Southern District of New York.

IN UNITED STATES DISTRICT COURT

[Title omitted]

CERTIFICATE OF PROBABLE CAUSE

The plaintiff having duly commenced this action by the service of a summons and a complaint upon the defendant, for the recovery of $4,441.61, with interest from December [fol. 26] 15, 1923, the amount of tax heretofore paid by the plaintiff to the defendant and the defendant having duly appeared herein by Emory R. Buckner, United States Attorney for the Southern District of New York and the court

having upon due deliberation denied the defendant's motion to dismiss the complaint and directed judgment in favor of the plaintiff against the defendant for the relief demanded in the complaint, and judgment in the sum of $5,188.82, having been entered by the clerk of this court on September 10, 1926, in favor of the plaintiff and against the defendant, pursuant to the order of the court entered herein September 2, 1926;

Now, therefore, pursuant to Section 989 of the Revised Statutes of the United States, I hereby certify that there was probable cause for the acts done by the defendant Frank K. Bowers, Collector of Internal Revenue for the Second District of New York which resulted in the entry of said judgment against him.

Dated New York, December 7, 1926.

Jno. C. Knox, U. S. D. J.

We hereby consent to the entry of the above certificate.

Baldwin, Hutchins & Todd, Attorneys for Plaintiff.

[fol. 27] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR WRIT OF ERROR

To the Honorable the Judges of the District Court of the United States for the Southern District of New York:

Now comes Frank K. Bowers, the defendant herein, by his attorney, Emory R. Buckner, United States Attorney for the Southern District of New York, and feeling himself aggrieved by the judgment entered herein on the 10th day of September, 1926, in favor of the plaintiff and against him, by which it was adjudged that the plaintiff have and recover of the defendant the sum of $5,188.82, and that plaintiff have execution therefor against said defendant, in which judgment and the proceedings had in this cause, certain errors were committed to the prejudice of this defendant, all of which more fully appears in the assignment of errors filed herewith;

Prays that a writ of error may be allowed to him from the United States Circuit Court of Appeals for the Second Circuit to the District Court of the United States for the Southern District of New York, for the correction of the [fol. 28] errors so complained of, and that a transcript of the record, proceedings and papers in this cause, duly authenticated, may be sent from said District Court to said Circuit Court of Appeals.

Dated New York, November 15, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant.

Office and P. O. Address: U. S. Courts and P. O. Bldg., Borough of Manhattan, City of New York.

IN UNITED STATES DISTRICT COURT

[Title omitted]

ASSIGNMENT OF ERRORS

Now comes the above named defendant by his attorney, Emory R. Buckner, United States Attorney for the Southern District of New York, and assigns error in the judgment of this Court entered September 10, 1926, in the following respects:

[fol. 29] 1. The Court erred in holding and deciding that the complaint stated facts sufficient to constitute a cause of action.

2. The Court erred in failing to hold that the complaint did not state facts sufficient to constitute a cause of action.

3. The Court erred in granting plaintiff's motion for judgment.

4. The Court erred in failing to deny plaintiff's motion for judgment.

5. The Court erred in directing the entry of judgment in favor of the plaintiff and against the defendant for the sum of $4,441.61, interest and costs, a total of $5,188.82.

6. The Court erred in directing the entry of judgment in favor of the plaintiff and against the defendant.

7. The Court erred in failing to dismiss the complaint.

8. The Court erred in failing to direct the entry of judgment in favor of the defendant and against the plaintiff, dismissing the complaint.

Wherefore defendant prays that said judgment of the District Court be reversed.

Dated New York, November 15, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant.

Address and Post Office Address: U. S. Courts & P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 30] Citation, in usual form, omitted in printing.

[fol. 31] In United States District Court

[Title omitted]

Stipulation re Transcript of Record

It is hereby stipulated and agreed, that the foregoing is a true transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

Dated December 14th, 1926.

Baldwin, Hutchins & Todd, Attorneys for Plaintiff.
Emory R. Buckner, U. S. Attorney, Attorney for Defendant.

[fol. 32] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 33] In United States Circuit Court of Appeals for the Second Circuit, October Term, 1926

Nos. 280-294

Argued May 20, 1927. Decided July 5, 1927

Frank K. Bowers, Collector of Internal Revenue for the Second District of the State of New York, Plaintiff in Error (Defendant Below),

v.

Elizabeth C. Taft, Defendant in Error (Plaintiff Below)

Frank K. Bowers, Collector of Internal Revenue for the Second District of the State of New York, Plaintiff in Error (Defendant Below),

v.

Gilbert C. Greenway, Jr., Defendant in Error (Plaintiff Below)

In Error to the District Court of the United States for the Southern District of New York

Before Manton, L. Hand, and Swan, Circuit Judges

Opinion

In Error to the District Court of the United States for the Southern District of New York.

Actions by Elizabeth C. Taft and by Gilbert C. Greenway, Jr., against Frank K. Bowers, Collector of Internal Revenue, to recover for income taxes paid under protest. Judgments for plaintiffs; defendant appeals. Reversed.

Charles H. Tuttle, U. S. Atty., of New York City (Samuel C. Coleman, Asst. U. S. Atty., of New York City, of counsel), for plaintiff in error.

Cadwalader, Wickersham & Taft, of New York City (Henry W. Taft and Clarence Castimore, both of New York City, of counsel), for defendant in error Taft.

Baldwin, Hutchins & Todd, of New York City (Robert A. Young and E. Raymond Shepard, both of New York City, of counsel), for defendant in error Greenway.

MANTON, Circuit Judge:

These cases were argued together and will be considered in one opinion. The defendant in error Miss Taft received a gift from her father of 150 shares of the common stock of the Nash Motors Company—100 shares in December, 1921, and 50 shares in March, 1922. They were transferred on the books of the corporation in her name on December 26, 1922, when she became the record owner thereof. They were obtained by her father as a bonus in connection with the purchase of preferred stock of the Nash Motors Company. In February, 1923, the Nash Motors Company declared a stock dividend of four shares of common and three [fol. 34] shares of preferred on each share of common stock to the stockholders of record on December 26, 1922. As a result she became the owner of 750 shares of common and 450 shares of preferred stock. After the receipt of this stock, in 1923, she sold 200 shares of common and 130 shares of preferred stock for $34,345.30. The market value of her 150 shares of common at the time she received the gift from her father was $42,350. The stock which she sold in 1923 brought $11,708 more than it was worth when she received it. In making her income tax return and paying the same for 1923, she included the entire gain of the sale of the stock sold by her as income for that year. This was required by section 202 (a) of the Revenue Act of 1921 (Comp. St. § 6336½bb). She paid a tax upon the basis of the original return, and thereafter protested against the tax upon the full amount of the proceeds, arguing that she should have been required to account, as income, for the difference between the value of the stock when she acquired it and the price at which she had sold it, to wit, $11,708.80.

In Mr. Greenway's case, the action is to recover a tax paid under protest as income tax for the year 1922, payment being made in 1923. The stock sold by this defendant in error was also a gift made by his brother to him. The stock was likewise sold at a profit.

The statute involved, section 202 (a) (2) of the Revenue Act of 1921, provides:

"(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property,

real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

"(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

A profit resulting from the conversion of capital assets is income, within the Sixteenth Amendment of the Constitution. Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509, 41 S. Ct. 386, 65 L. Ed. 751, 15 A. L. R. 1305; Eldorado Coal & Mining Co. v. Mager, 255 U. S. 522, 41 S. Ct. 390, 65 L. Ed. 757; Walsh v. Brewster, 255 U. S. 536, 41 S. Ct. 392, 65 L. Ed. 762. Income from gifts is treated in the same manner as income from other sources, and income has been defined as gain derived from capital and labor or from both combined provided it be understood to include profit or gain through a sale or conversion of capital assets. Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. The statute here attacked recognized this definition of income, and measures the profit or loss upon the sale or conversion of the gift as a difference between the price which the donor paid for it and the price which the donee obtained. The value of the property at the time the donor transferred it to the donee is ignored and Congress, in effect, charged the gift with the tax which the donor would have paid had he received the market value for it at the time of the gift.

The arguments of the defendants in error are that a gift is in the nature of capital assets, and that no tax is imposed upon the gift as such. The arguments further are that, by

taxing as income the difference between the cost to the donor and the price, realized by the donee, the tax is being imposed upon the corpus of the gifts themselves, and that section 213 (b) of the statute (Comp. St. § 6336⅛ff), forbids this. But the question is whether the method adopted by Congress for measuring income is, in the case of the donee, a reasonable one in the aid of the purposes of federal income taxation. Section 213 (b) does not define what is income from a gift. The defendants in error accede to the position that what each received when they sold the property, if it shows an increase, is a profit; but, in measuring it, the price at the date each received the gift must be assumed to be its worth to them. But Congress has measured otherwise, and it says, in protecting the government against loss of revenue, it is proper that, where the donee pays nothing, it accepts as a measure of gain or loss the cost to the donor without reference to its actual value when received by the donee.

[fol. 35] The obvious purpose of section 202 (a) (2) was to prevent the loss of income represented within the profit to the donor during the period he held the property before he made his gift. Congress has determined that this same increment shall be recognized as income, even though a gift intervenes. The transfer by gift is but a change of ownership in the specific property. In doing this, Congress imposes no tax upon an unrealized gain. The value of the property is ignored or not taken into account until the property is finally disposed of in such a way that it could be determined that the owner made either a gain or a loss, and, until there is a sale, there is no necessity for measuring income, nor is there an opportunity to do so. This avoids tax evasion or tax avoidance. This statute puts the donee, who pays nothing for the property, and who therefore loses nothing, on any theory of economic principle, in the position the donor would have been, in so far as taxation is concerned.

Nor does this method of taxation suggest that the statute is unconstitutional, as in violation of the Fifth Amendment. While the power to tax is not absolute, a tax should be shown to be arbitrary and capricious before it is condemned. The power of Congress to tax as permitted under the Sixteenth Amendment must be recognized, as well as

protection under the Fifth Amendment. The method of the statute which regards the corpus of the gift, irrespective of its value, as a thing which is transferred, is essential to the entire taxing scheme. The method results in no greater tax than that which would have been imposed upon the donor and the donee, if each had been asked to pay a proportion of the tax based upon the amount of the increment when in the hands of each. Only the income from the gift is affected by the statute. It is not the donee's income from other sources. The statute is prospective in operation, and relates to gifts made after a certain date. A donee must, therefore, be charged with the knowledge that under the law the gift may be worth less to him because of the necessity of sharing part of the profits with the government—that part which had accumulated up to the time he had received the gift. The argument against the constitutionality of the section loses sight of the fact that the statute is directed toward a means for collecting the revenue which is made available under the income tax statute. Knowlton v. Moore, 178 U. S. 41, 20 S. Ct. 747, 44 L. Ed. 969; N. Y. Trust Co. v. Eisner, 256 U. S. 345, 41 S. Ct. 506, 65 L. Ed. 963, 16 A. L. R. 660.

The statute may, indeed, be said to be an execution of the main design of the Income Tax Act. That it is proper to ignore the value of property at the time of the gift is illustrated by the excess profits tax. A tax upon a donor for making a gift is not in violation of the Constitution. Anderson v. McNeir, 16 F. (2d) 970.

The Supreme Court said, in La Belle Iron Works v. United States, 256 U. S. 377, 41 S. Ct. 528, 65 L. Ed. 998: "Nor can we regard the act—in basing 'invested capital' upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due process clause of the Fifth Amendment. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the states under the equal protection clause, much less of Congress under the more general requirement of due process of law in taxation. Of course, it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion, within the bounds

of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation."

So here Congress, in effect, has said that, notwithstanding the value of the property, from an economic standpoint, for the purpose of this taxation, that value is ignored, and only the value when the property was acquired by the donor is considered. This is deemed necessary to the enforcement of this aspect of the Income Tax Law, where a gift is made, and where a profit or loss is afterwards realized, and it becomes necessary to make proper measurement thereof. Although popularly the gift has a fixed value at the date of transfer, there is no constitutional objection, for income tax purposes, in rejecting or in ignoring that fact, and holding that the rights transferred by the gift, which include the increment while in the hands of the donor, are subject to the tax. No one would have doubted the power of Congress to impose a tax upon the donor at the time of the gift, and the tax could have been measured by the difference between the price he paid for it and its value when he trans- [fol. 36] ferred it. Nor could it be criticized if the donee was left to pay the balance of the tax, based upon the difference between the value on the date of acquisition and the value on the date of sale.

The statute does no more than tax the donee for a gift when he sells it, and measures that income for income tax purposes as based upon the difference between the cost when acquired by the donor and the price realized by the donee. It is not capricious to put property acquired by gift in a special class, and to tax it differently from property acquired by purchase. Bowman v. Cont. Oil Co., 256 U. S. 642, 41 S. Ct. 606, 65 L. Ed. 1139; Brushaber v. Union Pac. R. R. Co., 240 U. S. 1, 36 S. Ct. 236, 60 L. Ed. 493; Thomas v. U. S., 192 U. S. 363, 24 S. Ct. 305, 48 L. Ed. 481. It is sufficient, for the main purposes of the Sixteenth Amendment and the income tax enactments pursuant thereto, if the method of taxation is consistent with the entire scheme of taxation and the tax imposed by that method may not be considered direct.

We think that Congress, in levying the tax here, was well within its constitutional power in creating a classification which was reasonable, and neither the tax nor the method of enforcing it was arbitrary or capricious. Barclay & Co. v. Edwards, 267 U. S. 442, 45 S. Ct. 135, 348, 69 L. Ed. 703.

The judgments below are reversed, with costs.

Swan, Circuit Judge, dissents.

[fol. 37] In United States Circuit Court of Appeals

[Title omitted]

Concurring Opinion

L. Hand, Circuit Judge (concurring):

In each of these cases the amount of the tax does not exceed the increase in value of the gift while in the donee's hands. Strictly speaking, the question does not therefore arise whether Congress may, as a tax on income, seize any part of the increase in value of the gift before the donee accepted it. I am not entirely sure that a tax, if limited to the increase in the donee's hands, might not be calculated upon the difference between what the donor paid and the donee got. At the argument, I was disposed to think that these cases might be decided on some such reasoning, but it is pretty clear that that would make a new statute. Congress did not mean so to limit the tax. In the first place the results would be so capricious that the validity of the law might be doubtful, and in the second, much revenue would be lost which was certainly intended to be reached. We may hardly so far strain the law to save it. So I think that this act must be good in whole or not at all.

No increase in value not realized in cash can be taxed as income under the Sixteenth Amendment; that was very deliberately decided in Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. If so, it is impossible to tax the increase in the donor's hands at all; it is not income, though at any time by a sale he could have made it such. The same increase is as little income, even after it has passed to the donee, until he sells. However,

[fol. 38] it seems to me equally clear that when he does, there has been a gain which is in every sense income, to the extent of the difference between what the donor paid and the donee got. I am not concerned for the moment with whose gain it is, but that the whole gain is income cannot, I submit, be disputed. If it is important, I suggest that the language of the Amendment itself gives Congress power to lay "taxes on incomes," not on persons. Therefore there is a subject-matter which Congress may tax without apportionment, and part of which, after Eisner v. Macomber, it could not tax in any other way, except perhaps as an excise.

I can see no injustice in regarding the whole of this gain as income of the donee, and if there be no injustice certainly it is not within the Fifth Amendment. Suppose that the law charged the corpus of the gift while in the donor's hands with an inchoate tax at specified rates, to be calculated upon its increase whenever it was sold. The donee in accepting such a gift would take it subject to that charge, though its amount would remain undetermined until he sold. I can see nothing unconstitutional in that, nor in imposing upon him a corresponding duty in personam because of his acceptance. So far as that would involve uncertainty, arising from fluctuation in value of the gift after acceptance, it would be entirely within the donee's control, for he may sell when he likes, and could scarcely complain of any increase which might result from his delay. It is true that Congress has gone further than that, because it has made the whole gain a part of his income for the year in which he sells. But again so far as that is dependent upon the amount of his other income, he can reckon with it when he accepts the gift, and of any subsequent fluctuation he takes his chance, precisely as he does of fluctuation in the value of the gift.

Therefore I fail to see any oppression in this method of calculating the tax upon what, as I have said, appears to me an unquestionable subject-matter for taxation. In Lynch v. Turrish, 247 U. S. 221, 38 S. Ct. 537, 62 L. Ed. 1087, the gain had accrued before the amendment went into effect. I read Gray v. Darlington, 15 Wall. 63, 21 L. Ed. 45, in the same sense, though perhaps it was only a forerunner of Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. People ex rel. Brewster v. Wendell,

196 App. Div. 613, 188 N. Y. S. 510, dealt with a statute which sought to tax the donor, and was void where Eisner v. Macomber is law. That the statute is reasonably ancillary to a valid constitutional purpose seems to me as plain as in Rice v. Eisner, 16 F. (2d) 258 (C. C. A. 2); that the practice, if permissible, will become a common contrivance to frustrate that purpose, I have no doubt whatever.

I concur with my brother Manton.

[fol. 39] In United States Circuit Court of Appeals

[Title omitted]

Dissenting Opinion

Swan, Circuit Judge (dissenting):

I am unable to agree with the result reached by my colleagues. Section 202 (a) (2) of the Revenue Act of 1921 attempts to include as income of the donee, sustained upon sale of the gift, the increment in value which accrued during the time the property was owned by the donor, or by his predecessor in title if the donor himself received it as a gift. It has been established that Congress may not tax as income what in fact is not income, without apportioning the tax according to the constitutional requirement. Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. Property obtained by gift is capital, not income in the hands of the donee upon its receipt. Edwards v. Cuba Railroad, 268 U. S. 628, 45 S. Ct. 614, 69 L. Ed. 1124; United States v. Oregon-Washington, etc., Co., 251 F. 211 (C. C. A. 2). This is expressly recognized by the declaration of section 213 (b) (3) of the Revenue Act of 1921 to the effect that gross income shall not include the value of property acquired by gift, but only the income from such property. But section 202 defines the income from such property as including the increment in value which accrued [fol. 40] before the donee became owner of the property. This is an attempt to declare to be income of the donee, when realized by sale of the gift, something which was part of the donee's capital before the sale.

In Doyle v. Mitchell Bros. Co., 247 U. S. 179, 38 S. Ct. 467, 62 L. Ed. 1054, Mr. Justice Pitney, speaking for a unanimous court, said: "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration." It was held that, where the increase in capital value occurred before passage of the taxing act, such increase is not taxable as income upon sale of the property. A similar decision as to the Income Tax Act of 1913 (38 Stat. 114) appears in Lynch v. Turrish, 247 U. S. 221, 38 S. Ct. 537, 62 L. Ed. 1087.

I am unable to see why these cases are not applicable. The period under consideration in determining the gain realized by the taxpayer donee is the period of the donee's ownership. Only by giving an unreal valuation to the capital of the donee, namely, the cost of the gift to the donor or his predecessor in title, is it possible to consider the total gain above such cost as income to the donee realized by his sale. It does not seem to me a sufficient answer to say that the donee accepts the gift with knowledge that Congress has declared it to have this fictitious valuation for income tax purposes. The tax is not an excise on the privilege of accepting the gift; it is an income tax, and the tax payer's income must be a gain derived from his capital, or his labor, or from both combined.

It is my opinion, therefore, that the judgments should be affirmed.

[fol. 41] In United States Circuit Court of Appeals

[Title omitted]

Decree—Filed July 13, 1927

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed with costs. Further ordered that execution be issued for the collection of said costs.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

M. T. M. L. H.

[fol. 42] [File endorsement omitted.]

[fol. 43] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 44] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed November 21, 1927

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

The Chief Justice took no part in the consideration or decision of the petition for writ of certiorari in this case.

FILE COPY

SEP 26 1927

CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1927

No. 554

ELIZABETH C. TAFT,

Petitioner,

v.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO REVIEW THE DECISION OF THE UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT, AND BRIEF IN SUPPORT OF PETITION.

Constitutionality of Section 202 (a) (2), Revenue Act, 1921 (42 Stat. 227). The question presented by this petition is whether the provision of the above Act, which required a donee to use the cost of the property to the donor as a basis for computing profit for income-tax purposes, was unconstitutional in so far as it taxed to the donee, as income, increment in the value of a gift which accrued prior to its acquisition by the donee.

HENRY W. TAFT,
Counsel for Petitioner,
40 Wall Street,
New York, N. Y.

Lawyers Press, Inc., 165 William Street, New York City, N. Y.

Supreme Court of the United States

October Term, 1927

ELIZABETH C. TAFT,
Petitioner,

v.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

No.

Sir:

PLEASE TAKE NOTICE that I have filed in the Supreme Court of the United States a petition for a writ of certiorari in this cause, a copy of the record and a brief, of which copies are hereto annexed and herewith served upon you. Pursuant to Subdivision (4) of Rule 35 of the Supreme Court, the said petition, record and brief will be submitted to the Court on the first motion day following the expiration of twenty days after service of this notice upon you.

Dated, New York, September 19, 1927.

HENRY W. TAFT,
Attorney for Petitioner,
40 Wall Street,
New York, N. Y.

To—

HON. WILLIAM D. MITCHELL,
Solicitor General,
Washington, D. C.

Due service of the foregoing notice and the annexed petition, record and brief are hereby acknowledged.

Sept. , 1927.

Attorney for Respondent.

INDEX

	PAGE
Petition	1
Brief	7
I. A question of nation-wide interest and of vital and fundamental importance in our Income Tax Law is involved	7
II. It was error to hold that the increment in value which accrued prior to ownership by the Petitioner was "income"	8
III. It was error to hold that Section 202 (a) (2), Revenue Act 1921, was a legitimate and necessary exercise of a power ancillary to the power to levy taxes	12
IV. There was error in finding that the above provisions of the Act were not capricious and arbitrary	14
Conclusion	15
Opinion of District Court	17
Opinion of Judge Manton (C. C. A.)	20
Opinion of Judge Hand (C. C. A.)	28
Dissenting opinion of Judge Swan (C. C. A.)	31

Cases Cited.

Anderson v. McNeir, 16 Fed. (2) 970	13
Coolidge v. Nichols, May 31, 1927	14
Doyle v. Mitchell Bros. Co., 247 U. S. 179	10
Edwards v. Cuba R. R. Co., 268 U. S. 628	9
Eisner v. Macomber, 252 U. S. 189	9
Frew et al. v. Bowers, 12 Fed. (2) 625	14
Goodrich v. Edwards, 255 U. S. 527	9
Lynch v. Turrish, 247 U. S. 221	10
Merchants Loan & Trust Co. v. Smietanka, 255 U. S. 509	9
Miles v. Graham, 260 U. S. 501	15
Southern Pacific Co. v. Lowe, 247 U. S. 330	10
U. S. v. Oregon-Washington R. & Nav. Co., 251 Fed. 211	9
Walsh v. Brewster, 255 U. S. 536	10

Supreme Court of the United States

October Term, 1927

ELIZABETH C. TAFT,
Petitioner,

v.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

PETITION OF DEFENDANT IN ERROR FOR A WRIT OF CERTIORARI TO REVIEW THE DECISION OF THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Supreme Court of the United States:

The petition of Elizabeth C. Taft, the defendant in error below, respectfully shows:

I. That this suit was brought in the United States District Court for the Southern District of New York to recover $2,040.09, income tax, paid under protest by the petitioner to the respondent for the calendar year 1923, on the grounds that Section 202 (a) (2) of the Revenue Act of 1921 (42 Stat. 227), under which such tax was exacted, was contrary to Article 1, Sections 2 and 9 of the Constitution of the United States, and to the Fifth and the Sixteenth amendments thereof, and

also to other provisions of the same act which should prevail in its interpretation.

II. On the hearing in the District Court the motion of the defendant, Bowers, to dismiss the complaint of the plaintiff was denied, the Court holding that Section 202 (a) (2) of the said Revenue Act of 1921, in so far as it attempted to tax to the donee the increment in the value of the corpus of a gift which had accrued prior to acquisition by the donee, and was realized by the donee by conversion after the gift, was unconstitutional. A copy of the opinion of the District Court is hereto annexed.*

III. On appeal to the Circuit Court of Appeals for the Second Circuit the judgment of the District Court was reversed by a divided Court. The order reversing the judgment of the District Court was entered on the 13th day of July, 1927. Copies of the majority opinions of Judges Manton and Hand, and of the dissenting opinion of Judge Swan, of the Circuit Court, are hereto annexed.**

IV. Ninety days have not elapsed since the entry of the said order in accordance with the decision of the said Circuit Court of Appeals.

V. The petitioner respectfully moves this Court for a Writ of Certiorari to review the decision of the Circuit Court of Appeals, Second Circuit.

VI. The case of the petitioner is based on the following facts, concerning which there is no dispute. Her father gave to her, during 1921 and 1922, 150 shares of the common stock of The Nash Motors Company, which

* Page 17.
** Pages 20, 28, 31.

he had acquired as a bonus in connection with the purchase of preferred stock and for which, therefore, he could establish no definite cost. It is admitted by all concerned that the fair market value of the stock so given, on the date of the gifts, was $42,350. By reason of stock dividends paid early in 1923 the holdings of the petitioner increased to 750 shares of common stock and 450 shares of preferred stock. During 1923 she sold a portion of the said stock for $34,345.30. It is admitted by all concerned that the portion of the capital value at the time of the gift attributable to the shares so sold was $11,708.80. Obedient to the commands of Section 202 (a) (2) of the Revenue Act of 1921, which provided:

> "(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that * * *
>
> (2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor, or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

the petitioner returned the full amount of the proceeds of the sale of her stock, to wit, $34,345.30, as income, and

paid the tax thereon, protesting, however, that so much of the tax so paid, to wit, $2,040.09, as was exacted on the $11,708.80, being the increase in value accrued prior to her acquisition of the stock, was unlawful, and contrary to the provisions of the Constitution of the United States. Claim for refund of the said $2,040.09 was duly filed and after six months suit was duly brought in the District Court which raised the issue of the constitutionality of the provisions of Section 202 referred to above. (R. 4-8)

VII. For the reasons set forth in the annexed brief, your petitioner believes that the decision of the Circuit Court of Appeals was erroneous and contrary to law, and that this honorable Court should require the case to be certified to it for review and determination in conformity with the Acts of Congress in such case made and provided.

WHEREFORE your petitioner respectfully prays that a Writ of Certiorari may issue out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding the said Court to certify and transmit to this Court, on a day to be therein designated, a full and complete transcript of the record and all proceedings of the said Circuit Court of Appeals in the said case therein, entitled "Frank K. Bowers, Etc., Plaintiff in Error, v. Elizabeth C. Taft, Defendant in Error, (No. 280)," to the end that the case may be reviewed and determined in this Court, as provided by Section 240 of the Act of Congress designated as the Judicial Code, and that the said judgment of the said Circuit Court of Appeals in this case and every part thereof may be reviewed by this honorable Court and that the judgment of the District Court be confirmed

and that such other and further relief be granted as to the Court shall seem just and equitable and in conformity with the law.

ELIZABETH C. TAFT,
Petitioner.

HENRY W. TAFT,
Counsel.

STATE OF NEW YORK }
COUNTY OF NASSAU } ss.:

ELIZABETH C. TAFT, being duly sworn, says that she is the petitioner named in the foregoing petition, and that she has read the same, and that the allegations thereof are true, as she verily believes.

ELIZABETH C. TAFT.

Subscribed and sworn to before me
this 13th day of Sept., 1927.

WALTER H. PENNY,
Notary Public,
Nassau County, N. Y.

[SEAL]

IN THE

Supreme Court of the United States

October Term, 1927

ELIZABETH C. TAFT,
Petitioner,

v.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

BRIEF IN SUPPORT OF PETITION.

Insert

Statement.

This action was commenced by the petitioner in the United States District Court, Southern District of New York, to recover $2,040.90, income tax, paid in the year 1923, and is reported in 15 Fed. (2) 890. Judgment was entered for the petitioner on August 20, 1926. (R. 17-18.) The Circuit Court of Appeals reversed the judgment of the District Court. The opinions of the Circuit Court are not officially reported. The order reversing the judgment of the District Court was filed July 13, 1927. (R. 43-44.) In the proceeding below the petitioner claimed that the increment in the value of certain stock, to-wit, $11,708.80, which accrued prior to her ownership, was not income (R. 7), and, hence, the statute which taxed it as such was unconstitutional. (R. 8.) The petitioner relies upon Sec. 240 of the Judicial Code as authority for the jurisdiction of this Court. All of the material facts are set forth in Paragraph VI of the Petition and on pages 4-8 of the Record. The errors to be urged are specifically set forth in Points 2, 3, 4 of this brief.

IN THE

Supreme Court of the United States

October Term, 1927

ELIZABETH C. TAFT,
Petitioner,

v.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

BRIEF IN SUPPORT OF PETITION.

Insert

1. This case involves one of the most vital and fundamental problems of Income-Tax Law and is of nation-wide interest.

By reference to Section 202 (a) (2) of the Revenue Act of 1921, quoted in the accompanying petition, it will be noted that if a gift was made after December 31, 1920, the donee, in computing gain or loss, must use as the basis the cost to the donor or to the last preceding owner by whom it was not acquired by gift.

This is a new and decided departure in income-tax legislation. So far as diligent search has revealed, no Court has ever been called upon to pass on the validity of any similar income-tax statute, State or Federal. Despite the small amount involved, the case raises a question of great and fundamental importance, to wit: Whether Congress can constitutionally declare the increment in the value of a capital asset accruing prior to

ownership by a taxpayer to be income to that taxpayer. Thus if a person comes into the possession and ownership of property by gift and later sells the property so acquired, can he be taxed upon the basis of the increase in capital value from the time when the donor acquired it, up to the time he gave it to the donee? Is that increase income to the donee under the Income Tax Amendment? The District Court held that it was not. Upon appeal to the Circuit Court of Appeals the judgment was reversed, each of the three Judges sitting writing separate opinions, one dissenting. The two prevailing opinions did not proceed on the same lines of reasoning, nor can the opinions of the District Judge and the dissenting Circuit Judge be said to be clearly consistent. Thus, by a diversity of reasoning, two Judges have decided one way and two another. With such a contrariety of opinion upon such an important point, we submit that the interest of the public requires that the power of Congress to enact the legislation referred to should be definitely settled, especially since, of approximately six millions of persons required to make income-tax returns, many will undoubtedly be affected, at one time or another, as provisions similar to those in Section 202 (a) (2) are contained in all of the Federal Income Tax Acts since 1921.

2. The Circuit Court of Appeals erred in holding that the increment of $11,708.80 which accrued prior to the ownership by the petitioner was "income" taxable to the petitioner, or, indeed, was income at all.

This Court has defined income to be

> "The gain derived from capital, from labor, or from both combined, provided it is understood to

> include profit gained through a sale or conversion of capital assets." (Eisner v. Macomber, 252 U. S. 189.)

And the Court has since repeated and approved that definition in many cases. *Merchants Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509; *Goodrich* v. *Edwards,* 255 U. S. 527. It has thus become the settled criterion of what constitutes income within the meaning of the Sixteenth Amendment.

The definition does not include the value of property received by gift, for property so acquired is not gain derived *from* capital, *from* labor, or *from* both combined. Indeed, this Court has held, in *Edwards* v. *Cuba R. R. Co.,* 268 U. S. 628, that the value of physical properties and money given to the railroad company by way of subsidy by the Cuban Government is not income:

> "They are not profits or gains from the operation of the Railroad and do not constitute income within the meaning of the Sixteenth Amendment."

So, too, in *U. S.* v. *Oregon-Washington R. & Nav. Co.,* 251 Fed. 211 (C. C. A.), it was held that where a sole stockholder of a corporation released a debt in favor of the corporation, such sum was not income to the corporation, but was a capital contribution. For like reasons a gift is a capital transaction and does not constitute income to the donee. Increment accrued merely increases the value of the gift of capital. The provisions of the statute which attempt to call it income are inconsistent with Sec. 213 (b) of the Act, which provided that the value of a gift shall not be included in income.

No part of the capital value received by way of increment necessarily becomes income when realized by sale. Mere conversion of an asset into money does not

always result in income. To be sure, gain from the sale of capital assets is income. *Merchants Loan & Trust Co.* v. *Smietanka, supra; Walsh* v. *Brewster,* 255 U. S. 536. But the principle does not go so far as to hold that the increase in value which occurred prior to ownership by the person taxed should be included as such income, and for the reason that account must be taken of the taxpayer's capital investment at the beginning of this period of ownership before income in the constitutional sense can be estimated. Otherwise the gross receipts from every sale might be regarded as gross income to the seller, and this theory has long since been discarded by the courts. *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330. To state our position in another way, a donee can have profit *from* capital only when *his* capital at the beginning of his ownership is considered, just as he can have profit *from* labor only when the profit arises from *his* labor.

Analogous cases have been decided. In *Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179, the Court said:

> "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration."

It was held that where an increase in capital value occurred before the passage of the taxing Act, such increase was not taxable as income upon the sale of the property after the Act was effective. Again, in *Lynch* v. *Turrish,* 247 U. S. 221, it was held that capital which had accrued prior to March 1, 1913, was not income, although it was later converted into cash and paid to the taxpayer after that date. No sound distinction can be drawn between

a case where the increase accrued prior to the passage of the Act and a case where it accrued after that time but prior to ownership by the present taxpayer. In the first case the increase is not taxable because it had become capital when the law took effect. In the second case it was equally beyond the power of Congress to use (in the words of Judge Manton) as "a measure of gain or loss the cost to the donor without reference to its actual value when received by the donee" because any basis of measurement must have some relation to the thing measured. It can not create that basis by regarding as income what is, in fact, capital.

Here we note an obvious error of Judge Manton, in the following statement in his decision:

> "The stock which was sold in 1923 brought $11,708 more than it was worth when she received it. In making her income-tax return and paying the same for 1923, she included the entire gain from the sale of the stock sold by her as income for that year. This was required by Section 202 (a) of the Revenue Act of 1921. She paid a tax upon the basis of the original return and thereafter protested against the tax upon the full amount of the proceeds * * *."

The $11,708.80 referred to is the gain that accrued prior to the time of acquisition by the taxpayer. It was against the tax on this amount only that she protested. (R. 7) The gain of $22,836.50 which accrued between the time she acquired it and the time of sale she reported and paid the tax based thereon without protest, assuming, of course, that the question as to the tax on this gain had long since been settled by the case of *Walsh* v. *Brewster, supra,* and companion cases.

3. The Circuit Court of Appeals erred in holding that Sec. 202 (a) (2), Revenue Act of 1921, was a legitimate and necessary exercise of a power ancillary to the power to levy taxes.

The Court below was swayed by the fact that Congress was seeking to supply an omission in previous income-tax laws. Judge Manton, in his opinion, said:

> "The obvious purpose of Section 202 (a) (2) was to prevent the loss of income represented within the profit to the donor during the period he held the property before he made the gift."
>
> * * * * * * *
>
> "The method of the statute which regards the corpus of the gift, irrespective of its value, as a thing which is transferred is essential to the entire taxing scheme."
>
> * * * * * * *
>
> "The statute may, indeed, be said to be an execution of the main design of the income-tax Act."

Judge Hand, in his concurring opinion, stated:

> "That the statute is reasonably ancillary to a valid constitutional provision seems to me as plain as in Rice v. Eisner, 16 Fed. (2) 353; that the practice, if permissible, will become a common contrivance to frustrate that purpose I have no doubt whatever."

But the reasoning of neither Judge Manton nor Judge Hand answers the question as to whether or not the amount received by the donee was "income." This Court clearly decided in *Eisner* v. *Macomber, supra,* that the Sixteenth Amendment gives power to tax "income" only and that Congress can not, by statutory edict, con-

vert something into income which is not, in fact and substance, income, and tax it as such, without violating the Constitution. In that case the question of the taxation of stock dividends was involved. At the time the decision was made the Government was in dire need of revenue, and yet this Court did not allow its opinion to be influenced by that fact when it was convinced that stock dividends were not income.

Furthermore, both of the Judges below writing opinions for reversal sought to support their conclusions by pointing out that the gap might have been closed by an excise tax. Judge Manton stated:

> "No one would have doubted the power of Congress to impose a tax upon the donor at the time of the gift and the tax could have been measured by the difference between the price paid for it and its value when he transferred it. Nor could it be criticised if the donee was left to pay the balance of the tax based upon the difference between the value on the date of acquisition and the value on the date of sale."

Judge Hand stated:

> "Therefore there is a subject-matter which Congress may tax without apportionment and part of which, after Eisner v. Macomber, it could not tax in any other way, except, perhaps, as an excise."

An excise tax on a gift has been upheld. *Anderson* v. *McNeir,* 16 Fed. (2) 970. But this fact is not a valid reason for upholding an income tax on something which is not income. The majority members of the Court failed to recognize the distinction between the principle of an income-tax law and an excise-tax law which was so

clearly pointed out by Judge Swan in his dissenting opinion.

Speaking of the gain upon a sale of the donee's property, Judge Hand says:

> "I am not concerned for the moment with whose gain it is, but that the whole gain is income can not, I submit, be disputed. If it is important I suggest that the language of the Amendment itself gives Congress power to lay taxes on incomes, not on persons."

But Congress has not, in any income-tax law, taken that view of the Amendment. This is sufficiently illustrated by the fact that the law in question levies the tax on the "income of every individual" (Sec. 210) and the Act throughout refers to persons, "persons" being defined as including "partnerships and corporations as well as individuals." (Sec. 1.)

4. The Circuit Court of Appeals erred in finding that the provisions of the Act were not capricious and arbitrary.

That the taxing power of Congress is not absolute and may be an invasion of the rights of citizens under the Fifth Amendment has been established. *Walter E. Frew, et al.*, v. *Bowers*, 12 Fed. (2) 625, and more recently by this Court in *Coolidge* v. *Nichols*, May 31, 1927. Judge Manton, in pointing out that the Act was not discriminatory, stated:

> "The method results in no greater tax than that which would have been imposed upon the donor and donee if each had been asked to pay a proportion of the tax based upon the amount of the increment when in the hands of each."

This is clearly an erroneous statement, if the donor's income was small and the donee's large, or *vice versa*, as is generally the case. The donor does not take the same tax liability that the donor would have had, had he sold the property, and that is one of the reasons why the tax is arbitrary and capricious. That the donee took it, knowing that some day he might be called upon to pay the tax, does not affect the fundamental consideration that the sum when realized is not "income" to him or that the application of the statute works arbitrary and capricious results. *Miles* v. *Graham*, 260 U. S. 501. In that case it was held that where a Federal Judge took his office subsequent to the passage of the Revenue Act (and, of course, charged with knowledge of its provisions) which attempted to declare his salary to be taxable, he was not deprived of the benefit of Article 3, Section 1, of the Federal Constitution, which provides that his salary shall not be diminished. Similarly, a person who receives property by gift, even though he knows that there is a Federal Statute which attempts to impress upon him an income tax, is not thereby deprived of his fundamental rights under Article 1 of the Constitution and the Sixteenth and Fifth Amendments thereof.

Conclusion.

Wherefore the petitioner respectfully prays that this Court take jurisdiction of this question because:

1. This case involves a vital and fundamental principle of income-tax law and is of great public interest.

2. The Court below erred in finding that increment in value which occurred prior to the ownership by the donee was income taxable to the donee.

3. The Court below erred in holding that Section 202 (a) (2) of the Revenue Act of 1921 was a legitimate and necessary exercise of a power ancillary to the power to levy taxes on incomes.

4. The Court below erred in finding that the application of the Statute, as applied to the donee, is not an arbitrary and capricious exercise of the power of taxation.

HENRY W. TAFT,
Counsel for the Petitioner,
40 Wall Street,
New York, N. Y.

Opinion of Judge Knox.

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

ELIZABETH C. TAFT, *Plaintiff*, v. FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York, *Defendant.*	L 35/86
GILBERT C. GREENWAY, JR., *Plaintiff*, v. FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York, *Defendant.*	L 38/3

CADWALADER, WICKERSHAM & TAFT, Esqs., Attorneys for Plaintiff (HENRY W. TAFT and CLARENCE CASTIMORE, Esqs., of counsel);

BALDWIN, HUTCHINS & TODD, Esqs., Attorneys for Plaintiff (ROBERT A. YOUNG and E. RAYMOND SHEPARD, Esqs., of counsel);

HON. EMORY R. BUCKNER, United States Attorney, Attorney for Defendant (SHERWOOD E. HALL, Esq., Assistant United States Attorney, of counsel).

KNOX, *D. J.*:

It is my opinion that no part or portion of the value of an outright bona fide gift as of the date of delivery is, or can, constitute taxable income in the hands of the donee. So far as the latter is concerned, the gift is a capital transaction. His liability for future income therefrom must be based on the value of the gift as of the time the transaction is complete, and not upon the cost of the property at the date of its acquisition by the donor. If the construction of the tax law, for which the Government contends, should be applied, it means that the donee of property is to be taxed upon an increment in value which, if it can be regarded as income at all, is income to another, viz.: the donor. A tax levied upon that increment in the hands of the donee necessarily results in a direct levy upon the gift. If the gift consisted of money, would it be argued that the donee is to be taxed on the difference in value of the money, that is, its purchasing power, as between the date of its acquisition by the donor, and the date of its delivery to the donee? I think not. The money would be regarded as capital in the hands of the donee; and so, I think that that which may be converted into money, as of the date upon which it is given away, must, so far as the donee is concerned, also be regarded as capital.

According to my views, the 16th Amendment to the Constitution conferred no power upon the Congress to tax gifts.

Very likely, it is possible to devise reasonably plausible arguments to the effect that what is transferred by the donor is nothing more than his original investment

therein, and to cite various decisions which contain expressions that may be tortured to support the argument; but the fact remains that the common understanding of a gift is that the donee acquires, absolutely and completely, the entire value of the donation as of the date of transfer. Until a higher court than this is willing to endorse a different principle, I certainly shall not do so.

The motion to dismiss the complaint is denied and the plaintiffs may have judgment for the claim asserted against the Collector. He, of course, will be granted a certificate.

August 5, 1926.

U. S. D. J.

Opinion of Judge Manton.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Plaintiff-in-Error (Defendant below),

against

ELIZABETH C. TAFT,
Defendant-in-Error (Plaintiff below).

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Plaintiff-in-Error (Defendant below),

against

GILBERT C. GREENWAY, JR.,
Defendant-in-Error (Plaintiff below).

Before: MANTON, L. HAND and SWAN, *Circuit Judges.*

Writ of error to the District Court for the Southern District of New York. Actions by Elizabeth C. Taft and Gilbert C. Greenway, Jr., against Frank K. Bowers, Collector of Internal Revenue, defendant, to recover for

income taxes paid under protest. Judgments for plaintiffs; defendant appeals. Reversed.

CADWALADER, WICKERSHAM & TAFT, Esqs.,
Attorneys for Elizabeth C. Taft.
HENRY W. TAFT, Esq.,
CLARENCE CASTIMORE, Esq.,
of Counsel.

BALDWIN, HUTCHINS & TODD, Esqs.,
Attorneys for G. C. Greenway, Jr.
ROBERT A. YOUNG, Esq.,
E. RAYMOND SHEPARD, Esq.,
of Counsel.

CHARLES H. TUTTLE, Esq.,
United States Attorney.
SAMUEL C. COLEMAN, Esq.,
Asst. U. S. Attorney, of Counsel.

MANTON, *Circuit Judge:*

These cases were argued together and will be considered in one opinion. The defendant-in-error, Miss Taft, received a gift from her father of 150 shares of the common stock of the Nash Motors Company; 100 shares in December, 1921, and 50 shares in March, 1922. They were transferred on the books of the corporation in her name on December 26, 1922, when she became the record owner thereof. They were obtained by her father as a bonus in connection with the purchase of preferred stock of the Nash Motors Co. In February, 1923, the Nash Motors Co. declared a stock dividend of four shares of common and three shares of preferred on each share of common stock to the stockholders of record on December 26, 1922. As a result, she became the owner of 750 shares of common and 450 shares of preferred stock. After the receipt of this stock in 1923, she sold 200 shares

of common and 130 shares of preferred stock for $34,345.30. The market value of her 150 shares of common at the time she received the gift from her father was $42,350. The stock which she sold in 1923 brought $11,708 more than it was worth when she received it. In making her income tax return and paying the same for 1923, she included the entire gain of the sale of the stock sold by her as income for that year. This was required by §202 (a) of the Revenue Act of 1921. She paid a tax upon the basis of the original return and thereafter protested against the tax upon the full amount of the proceeds, arguing that she should have been required to account, as income, for the difference between the value of the stock when she acquired it and the price at which she had sold it, to wit, $11,708.80.

In Mr. Greenway's case, the action is to recover a tax paid under protest as income tax for the year 1922, payment being made in 1923. The stock sold by this defendant-in-error was also a gift made by his brother to him. The stock was likewise sold at a profit.

The statute involved, §202 (a) (2) of the Revenue Act of 1921, provides:

> "(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—"
>
> * * * * * * * *
>
> "(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee,

the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

A profit resulting from the conversion of capital assets is income within the Sixteenth Amendment of the Constitution. *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509; *Eldorado Coal & Mining Co.* v. *Mager*, 255 U. S. 522; *Walsh* v. *Brewster*, 255 U. S. 536. Income from gifts is treated in the same manner as income from other sources, and income has been defined as gain derived from capital and labor or from both combined provided it be understood to include profit or gain through a sale or conversion of capital assets. *Eisner* v. *Macomber*, 252 U. S. 189. The statute here attacked recognized this definition of income and measures the profit or loss upon the sale or conversion of the gift as a difference between the price which the donor paid for it and the price which the donee obtained. The value of the property at the time the donor transferred it to the donee is ignored and Congress, in effect, charged the gift with the tax which the donor would have paid had he received the market value for it at the time of the gift.

The arguments of the defendants-in-error are that a gift is in the nature of capital assets and that no tax is imposed upon the gift as such. The arguments further are that by taxing as income the difference between the cost to the donor and the price realized by the donee,

the tax is being imposed upon the corpus of the gifts themselves and that §213 (b) of the statute forbids this. But the question is whether the method adopted by Congress for measuring income is, in the case of the donee, a reasonable one in the aid of the purposes of Federal income taxation. Section 213 (b) does not define what is income from a gift. The defendants-in-error accede to the position that what each received when they sold the property, if it shows an increase, is a profit but in measuring it, the price at the date each received the gift must be assumed to be its worth to them. But Congress has measured otherwise and it says, in protecting the government against loss of revenue, it is proper that where the donee pays nothing, it accepts as a measure of gain or loss the cost to the donor without reference to its actual value when received by the donee.

The obvious purpose of §202 (a) (2) was to prevent the loss of income represented within the profit to the donor during the period he held the property before he made his gift. Congress has determined that this same increment shall be recognized as income, even though a gift intervenes. The transfer by gift is but a change of ownership in the specific property. In doing this, Congress imposes no tax upon an unrealized gain. The value of the property is ignored or not taken into account until the property is finally disposed of in such a way that it could be determined that the owner made either a gain or a loss and, until there is a sale, there is no necessity for measuring income nor is there an opportunity to do so. This avoids tax evasion or tax avoidance. This statute puts the donee, who pays nothing for the property and who, therefore, loses nothing on any theory of eco-

nomic principle, in the position the donor would have been, in so far as taxation is concerned.

Nor does this method of taxation suggest that the statute is unconstitutional as in violation of the Fifth Amendment. While the power to tax is not absolute, a tax should be shown to be arbitrary and capricious before it is condemned. The power of Congress to tax as permitted under the Sixteenth Amendment must be recognized as well as protection under the Fifth Amendment. The method of the statute which regards the corpus of the gift, irrespective of its value, as a thing which is transferred is essential to the entire taxing scheme. The method results in no greater tax than that which would have been imposed upon the donor and the donee, if each had been asked to pay a proportion of the tax based upon the amount of the increment when in the hands of each. Only the income from the gift is affected by the statute. It is not the donee's income from other sources. The statute is prospective in operation and relates to gifts made after a certain date. A donee must, therefore, be charged with the knowledge that under the law, the gift may be worth less to him because of the necessity of sharing part of the profits with the government —that part which had accumulated up to the time he had received the gift. The argument against the constitutionality of the section loses sight of the fact that the statute is directed toward a means for collecting the revenue which is made available under the income tax statute. *Knowleton* v. *Moore,* 178 U. S. 41; *N. Y. Trust Co.* v. *Eisner,* 256 U. S. 345.

The statute may, indeed, be said to be an execution of the main design of the income tax act. That it is proper to ignore the value of property at the time of the

gift is illustrated by the Excess Profits Tax. A tax upon a donor for making a gift is not in violation of the Constitution. *Anderson* v. *McNeir*, 16 F. (2d) 970.

The Supreme Court said in *LaBelle Iron Works* v. *United States*, 256 U. S. 377:

> "Nor can we regard the act—in basing 'invested capital' upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due process clause of the Fifth Amendment. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the States under the equal protection clause, much less of Congress under the more general requirement of due process of law in taxation. Of course it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion within the bounds of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation."

So here Congress, in effect, has said that notwithstanding the value of the property, from an economic standpoint for the purpose of this taxation, that value is ignored and only the value when the property was acquired by the donor is considered. This is deemed necessary to the enforcement of this aspect of the Income Tax Law where a gift is made and where a profit or loss is afterwards realized and it becomes necessary to make proper measurement thereof. Although popularly the

gift has a fixed value at the date of transfer, there is no Constitutional objection, for income tax purposes, in rejecting or in ignoring that fact and holding that the rights transferred by the gift which include the increment while in the hands of the donor, are subject to the tax. No one would have doubted the power of Congress to impose a tax upon the donor at the time of the gift and the tax could have been measured by the difference between the price he paid for it and its value when he transferred it. Nor could it be criticized if the donee was left to pay the balance of the tax based upon the difference between the value on the date of acquisition and the value on the date of sale. The statute does no more than tax the donee for a gift when he sells it and measures that income for income tax purposes as based upon the difference between the cost when acquired by the donor and the price realized by the donee. It is not capricious to put property acquired by gift in a special class and to tax it differently from property acquired by purchase. *Bowman* v. *Cont. Oil Co.*, 256 U. S. 642; *Brushaber* v. *Union Pac. R.R. Co.*, 240 U. S. 1; *Thomas* v. *U. S.*, 192 U. S. 363. It is sufficient for the main purposes of the Sixteenth Amendment and the Income Tax enactments pursuant thereto, if the method of taxation is consistent with the entire scheme of taxation and the tax imposed by that method may not be considered direct.

We think that Congress in levying the tax here was well within its constitutional power in creating a classification which was reasonable and neither the tax nor the method of enforcing it was arbitrary or capricious. *Barclay & Co.* v. *Edwards*, 267 U. S. 442.

The judgments below are reversed with costs.

Judge Swan dissents.

Opinion of Judge Hand.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT.

FRANK K. BOWERS, Etc.,
Plaintiff-in-Error,

against

ELIZABETH C. TAFT,
Defendant-in-Error.

FRANK K. BOWERS, Etc.,
Plaintiff-in-Error,

against

GILBERT C. GREENWAY, JR.,
Defendant-in-Error.

L. HAND, Circuit Judge (concurring): In each of these cases the amount of the tax does not exceed the increase in value of the gift while in the donee's hands. Strictly speaking, the question does not therefore arise whether Congress may, as a tax on income, seize any part of the increase in value of the gift before the donee accepted it. I am not entirely sure that a tax, if limited to the increase in the donee's hands, might not be calculated upon the difference between what the donor paid and the donee got. At the argument, I was disposed to think that these cases might be decided on some such reasoning, but it is pretty clear that that would make a new statute. Congress did not mean so to limit the tax. In the first place the results would be so capricious that the validity

of the law might be doubtful, and in the second, much revenue would be lost which was certainly intended to be reached. We may hardly so far strain the law to save it. So I think that this act must be good in whole or not at all.

No increase in value not realized in cash can be taxed as income under the Sixteenth Amendment; that was very deliberately decided in *Eisner* v. *Macomber*, 252 U. S. 189. If so, it is impossible to tax the increase in the donor's hands at all; it is not income, though at any time by a sale he could have made it such. The same increase is as little income, even after it has passed to the donee, until he sells. However, it seems to me equally clear that when he does, there has been a gain which is in every sense income, to the extent of the difference between what the donor paid and the donee got. I am not concerned for the moment with whose gain it is, but that the whole gain is income cannot, I submit, be disputed. If it is important, I suggest that the language of the Amendment itself gives Congress power to lay "taxes on incomes," not on persons. Therefore, there is a subject-matter which Congress may tax without apportionment, and part of which, after *Eisner* v. *Macomber*, it could not tax in any other way, except perhaps as an excise.

I can see no injustice in regarding the whole of this gain as income of the donee, and if there be no injustice certainly it is not within the Fifth Amendment. Suppose that the law charged the corpus of the gift while in the donor's hands with an inchoate tax at specified rates, to be calculated upon its increase whenever it was sold. The donee in accepting such a gift would take it subject to that charge, though its amount would remain unde-

termined until he sold. I can see nothing unconstitutional in that, nor in imposing upon him a corresponding duty in personam because of his acceptance. So far as that would involve uncertainty, arising from fluctuation in value of the gift after acceptance, it would be entirely within the donee's control, for he may sell when he likes, and could scarcely complain of any increase which might result from his delay. It is true that Congress has gone further than that, because it has made the whole gain a part of his income for the year in which he sells. But again so far as that is dependent upon the amount of his other income, he can reckon with it when he accepts the gift, and of any subsequent fluctuation he takes his chance, precisely as he does of fluctuation in the value of the gift.

Therefore, I fail to see any oppression in this method of calculating the tax upon what, as I have said, appears to me an unquestionable subject-matter for taxation. In *Lynch* v. *Turrish,* 247 U. S. 221, the gain had accrued before the Amendment went into effect. I read *Gray* v. *Darlington,* 15 Wall. 63, in the same sense, though perhaps it was only a forerunner of *Eisner* v. *Macomber,* 252 U. S. 189. *People ex rel. Brewster* v. *Wendell,* 196 App. Div. 596, dealt with a statute which sought to tax the donor, and was void where *Eisner* v. *Macomber* is law. That the statute is reasonably ancillary to a valid constitutional purpose seems to me as plain as in *Rice* v. *Eisner,* 16 Fed. (2) 358 (C. C. A. 2); that the practise, if permissible, will become a common contrivance to frustrate that purpose, I have no doubt whatever.

I concur with my brother Manton.

Dissenting Opinion of Judge Swan.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT.

FRANK K. BOWERS, Etc.,
Plaintiff-in-Error,

v.

ELIZABETH C. TAFT,
Defendant-in-Error.

FRANK K. BOWERS, Etc.,
Plaintiff-in-Error,

v.

GILBERT C. GREENWAY, JR.,
Defendant-in-Error.

SWAN, Circuit Judge (dissenting): I am unable to agree with the result reached by my colleagues. Section 202 (a) (2) of the Revenue Act of 1921 attempts to include as income of the donee, sustained upon sale of the gift, the increment in value which accrued during the time the property was owned by the donor, or by his predecessor in title if the donor himself received it as a gift. It has been established that Congress may not tax as income what in fact is not income, without apportioning the tax according to the constitutional requirement. *Eisner* v. *Macomber*, 252 U. S. 189. Property obtained by gift is capital, not income in the hands of the donee upon its receipt. *Edwards* v. *Cuba Railroad*, 268 U. S. 628; *United States* v. *Oregon-Washington &c Co.*, 251 F. 211 (C. C. A. 2). This is expressly recognized by the declaration of Section 213 (b) (3) of the Revenue Act of 1921 to the effect that gross income shall not include the value

of property acquired by gift but only the income from such property. But Section 202 defines the income from such property as including the increment in value which accrued before the donee became owner of the property. This is an attempt to declare to be income of the donee, when realized by sale of the gift, something which was part of the donee's capital before the sale.

In *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, Mr. Justice Pitney, speaking for a unanimous court, said:

> "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration."

It was held that where the increase in capital value occurred before the passage of the taxing act, such increase is not taxable as income upon sale of the property. A similar decision as to the Income Tax Act of 1913 appears in *Lynch* v. *Turrish*, 247 U. S. 221. I am unable to see why these cases are not applicable. The period under consideration in determining the gain realized by the taxpayer donee is the period of the donee's ownership. Only by giving an unreal valuation to the capital of the donee, namely, the cost of the gift to the donor or his predecessor in title, is it possible to consider the total gain above such cost as income to the donee realized by his sale. It does not seem to me a sufficient answer to say that the donee accepts the gift with knowledge that Congress has declared it to have this fictitious valuation for income tax purposes. The tax is not an excise on the privilege of accepting the gift; it is an income tax, and the taxpayer's income must be a gain derived from *his* capital, or *his* labor, or from both combined.

It is my opinion, therefore, that the judgments should be affirmed.

FILE COPY

APR 5 1928
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1927

No. 554 16

ELIZABETH C. TAFT, *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR PETITIONER

Supreme Court of the United States

October Term, 1927

No. 554

ELIZABETH C. TAFT, *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York, *Respondent.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

INDEX

	Page
Statement of the Case	1
Statute in Question	4
Argument:	
I. The Circuit Court of Appeals erred in holding that the increment of $11,708.80 which accrued prior to ownership by the Petitioner was "income" taxable to the Petitioner, or, indeed, that it was income at all	6
II. The Circuit Court of Appeals erred in finding that the provisions of Section 202 (a) (2) of the Revenue Act of 1921 were not capricious and arbitrary and contrary to the Fifth Amendment of the United States Constitution	10
III. The Circuit Court of Appeals erred in holding that Section 202 (a) (2) of the Revenue Act of 1921 was a legitimate and necessary exercise of the power ancillary to the power to levy taxes	12

Cases Cited

Bankers Trust Co. v. Bowers, 23 Fed. (2nd) 941	14
Blodgett v. Holden, 275 U. S. 142	12
Brewster v. Gage, unreported	14
Coolidge v. Nichols, 274 U. S. 531	12
Doyle v. Mitchell Bros., 247 U. S. 179	9
Edwards v. Cuba R. R. Co., 268 U. S. 628	7, 8
Eisner v. Macomber, 252 U. S. 189	7, 9, 10, 13
Frew v. Bowers, 12 Fed. (2nd) 625	12
Goodrich v. Edwards, 255 U. S. 527	8, 11
Gould v. Gould, 245 U. S. 151	11
Lynch v. Turrish, 247 U. S. 221	8
Appeal of Mathiessen, 2 B. T. A. 921	15
Merchants Loan & Trust Co. v. Smietanka, 255 U. S. 509	6
Miles v. Graham, 268 U. S. 501	14
People ex rel. Wilson v. Wendell, 196 N. Y. App. Div. 596	14
Rice v. Eisner, 16 Fed. (2nd) 358	6
Southern Pacific Co. v. Lowe, 247 U. S. 330	11
United States v. Flannery, 268 U. S. 98	11
United States v. Hill, 120 U. S. 169	8
United States v. Oregon-Washington R. & Nav. Co., 251 Fed. 211	7, 8, 11

Statutes Cited

Revenue Act of 1921, 42 Stat. L. 227-321	3, 4
Revenue Act of 1918, 40 Stat. L. 1057-96	7
Revenue Act of 1916, 39 Stat. L. 756-77	7
Judicial Code, Section 240	1

Supreme Court of the United States

October Term, 1927

No. 554

ELIZABETH C. TAFT, *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

BRIEF FOR PETITIONER.

Statement.

The opinion of the United States District Court for the Southern District of New York in the above case is reported in 15 Fed. (2) 890. The opinions of the Judges of the Circuit Court of Appeals for the Second Circuit are reported in 20 Fed. (2) 561.

This cause comes before this Court on a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit granted by this Court on November 21, 1927, to review a decree of the United States Circuit Court of Appeals, Second Circuit, filed on July 13, 1927 (R. 24). The petitioner relies upon the provisions of Section 240 of the Judicial Code as authority for the jurisdiction of this Court.

The facts involved are not complicated. Elizabeth C. Taft, the petitioner, received from her father by gift one hundred fifty (150) shares of the common stock of The Nash Motors Company, a corporation duly organized and existing under the laws of the State of Maryland. One hundred (100) of these were received by her on or about December 12, 1921, and fifty (50) shares were received by her on or about March 18, 1922 (R. 3). Her father had acquired the said shares as a bonus with a purchase of other stock of The Nash Motors Company at about the time of its incorporation in 1916, and he could not establish that the stock had cost him any definite sum (R. 4). In other words, for the purposes of this action the basis of cost in the hands of the donor was nothing. The said shares were transferred on the books of the corporation to the petitioner's name, so that on December 26, 1922, she was the owner of record of one hundred fifty (150) shares of the said common stock of The Nash Motors Company (R. 3).

On or about February 1, 1923, The Nash Motors Company declared a stock dividend of four shares of common stock and three shares of preferred stock on each share of common stock, to shareholders of record on December 26, 1922. Accordingly the petitioner received during 1923, as a stock dividend, six hundred (600) shares of the common stock and four hundred fifty (450) shares of the preferred stock of The Nash Motors Company. She thus became the owner of record of seven hundred fifty (750) shares of the common stock and four hundred fifty (450) shares of the preferred stock of the company (R. 3).

During the year 1923 and after the receipt of the stock dividend the petitioner sold two hundred (200) shares of the common stock and one hundred thirty (130) shares

of the preferred stock of the said company for $34,345.30 (R. 3 and 4).

On or about March 15, 1924, she made her individual income tax return to the United States Government for the calendar year 1923 showing a net income of $40,972.75 (R. 4) and included therein the total amount of the receipts of such sale, to wit, $34,345.30, as income on her return, in accordance with the requirements of Section 202 (a) (2) of the Revenue Act of 1921 (42 Stat. at Large, Chapter 136, pp. 227-321) then in force. On or before June 15 of the same year the petitioner paid to the respondent but under protest, the entire amount of tax calculated to be payable on the basis of the return so filed, to wit, $4,320.50 (R. 4).

The total fair market value of the one hundred fifty (150) shares of common stock at the time it was given to the petitioner was $42,350 (R. 4). The proportion of this amount allocated according to the rulings of the United States Treasury Department to the stock originally issued and to that issued as a dividend gave to the two hundred (200) shares of common stock and the one hundred thirty (130) shares of preferred stock sold by the petitioner in 1923 a value of $11,708.80 as of the time she acquired it (R. 4). In other words, the increment attributable to the shares sold which had accrued prior to acquisition by the petitioner was $11,708.80, and she claims that the income tax can not be based upon that increment, because it accrued before she owned the stock. She was, however, required to state it in her return and has paid in respect of it a tax of $2,040.09, which she now seeks to recover (R. 5).

On or about June 15, 1924, and within the time prescribed by law, the petitioner took an appeal to the Commissioner of Internal Revenue by filing with the respon-

dent a claim for a refund of the tax so paid on the said $11,708.80 (R. 5). After six months—the Commissioner having taken no action on the claim in that period—suit was brought in the United States District Court for the Southern District of New York for the recovery of the tax on the ground that the tax on the $11,708.80 of increment which accrued prior to the ownership of the stock by the petitioner was illegally and erroneously collected (R. 3-6).

The Statutes.

Section 202 (a) (2) of the Revenue Act of 1921 [42 Stat. at Large, 227-321] provides:

> "(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—"
>
> • • • • • • • • • •
>
> "(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

Section 213 (a) of the Revenue Act of 1921 provides:

"That for the purposes of this title (except as otherwise provided in Section 233) the term 'gross income' (a) includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

"(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * * * * * *

"(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income)."

ARGUMENT.

POINT I.

The Circuit Court of Appeals erred in holding that the increment of $11,708.80 which accrued prior to ownership by the petitioner was "income" taxable to the petitioner, or, indeed, that it was income at all.

This case involves a basic and important principle of Income Tax Law. Fundamentally it seems to us that it must be determined whether the power granted to Congress by the Sixteenth Amendment to the Constitution to "lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States," empowers the Congress to ignore the identity of separate taxpayers, set an arbitrary basis for determining gain or loss on the sale of capital assets and tax to the last successor in title as income any increase in value between the basis so fixed and the amount realized, although such increase, or some of it, may have occurred long prior to the time when the present taxpayer owned, possessed or had any right of disposition and control over the property.

At the outset let it be said that this case does not involve the taxation of any gain derived upon the increase in value after acquisition of the property by the petitioner, and hence the case of *Rice* v. *Eisner* (16 Fed. 2d, 358; certiorari denied) can have no bearing. The petitioner returned the gain so made as income and paid the tax upon it without asking for any refund (R. 5), assuming that the question of the taxation of that profit had long since been settled in *Merchants Loan & Trust Co.*

v. *Smietanka,* 255 U. S. 509, and companion cases. We are therefore confronted with the single question as to whether the $11,708.80 representing increment in value which accrued prior to acquisition by the petitioner was "income" to her in 1923 when converted into cash by sale.

"Income" has been defined to mean "the gain derived from capital, labor, or from both combined, provided it is understood to include profit gained through a sale or conversion of capital assets" (*Eisner* v. *Macomber,* 252 U. S. 189, 207). In order to apply this definition, we must determine first what is profit or gain to the taxpayer. The value of the gift itself is not profit or gain, but is capital in the hands of the donee (*Edwards* v. *Cuba R. R. Co.,* 268 U. S. 628; *U. S.* v. *Oregon-Washington R. & Nav. Co.,* 251 Fed. 211 C. C. A.). Indeed the statute itself specifically provides that a gift is not to be included in the gross income of the donee. See Section 213 (b) (3) above. Moreover, as the gifts were received in 1921 and 1922, the question of taxing them in 1923, the year here under review, is not directly involved.

Prior to the year 1921 there was no specific provision in the various Revenue Acts which fixed the basis for determining gain or loss on the sale of property acquired by gift, devise or bequest. The statute provided that the basis to determine gain on the sale of assets was cost or March 1, 1913, value (Rev. Act 1918, 40 Stat. at Large, Chapter 18, p. 1060; Rev. Act. 1916, 39 Stat. at Large, Chapter 463, page 758).

The uniform rule of the Treasury Department under these prior statutes was that the basis to be used for determining gain upon the sale of an asset acquired by gift, devise or bequest was the value of such property when acquired. (U. S. Treasury Department Regulations 33

Rev. Art. 4; U. S. Treasury Department Regulations 45, Art. 1562); and indeed the regulations still provide, with respect to gifts made prior to December 31, 1920, that the basis is the value when acquired. (U. S. Treasury Department Regulations 69, Art. 1594.) In other words, until the Revenue Act of 1921 became effective the Department laid down the rule that gain on the sale of property acquired by gift could be computed only by taking into consideration the value of the gift, when it was acquired. This was an express recognition by the Treasury Department that a gift is a capital transaction, as pointed out in *Edwards* v. *Cuba R. R. Co.* and *U. S.* v. *Oregon-Washington R. & Nav. Co., supra,* and that the donee can have "gain" only to the extent that the proceeds in his hands exceed the value of his capital at the time of acquisition. These rulings are entitled to great weight (*U. S.* v. *Hill,* 120 U. S. 169, 188). If they are sound—and we submit that they are—then no basis other than value at acquisition by the donee should be adopted to determine what is "gain" upon the sale of the property and one that adopts any other method is contrary to all of the established and settled conceptions of computing gain on capital assets.

In *Goodrich* v. *Edwards,* 255 U. S. 527, this Court held that the Income Tax Act of 1916 taxed "gains" only, and that a taxpayer could have no gain until the proceeds of the sale exceeded his cost, even though the proceeds may have exceeded the March 1, 1913, value. In *Lynch* v. *Turrish,* 247 U. S. 221, this Court passed upon the question as to whether an increase in the value of capital assets which has accrued prior to March 1, 1913, was income to a taxpayer when realized after that date at a very great increase over the cost price. In passing upon the question this Court said that there was "no increase sub-

ject to tax," allowing the taxpayer to recover his capital investment on March 1, 1913. So also in *Doyle* v. *Mitchell Bros.*, 247 U. S. 179, this Court refused to tax to a corporation as income an increase which had accrued prior to the passage of the Corporation Franchise Tax Law of 1909, but realized by sale by the corporation after the Act was effective, saying:

> "In order to determine whether there has been gain or loss, and the amount of gain if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration."

We see no reason for distinguishing between a case where the increase occurred prior to the passage of the taxing statute and a case where the increase occurred prior to ownership by the present taxpayer. If a taxpayer in the former case is entitled to recover his capital investment before he can have any gain *a fortiori*, a taxpayer in the latter case should be entitled to recover his capital investment which he acquired at the date of the gift. We submit that the above decisions lay down definitely the principle that a taxpayer is entitled to recover *his* cost or capital investment before he can have gain or income.

If then a taxpayer's capital investment at the time of acquisition is not "income", as it is is usually understood, a statute which seeks to make it such is invalid. In *Eisner* v. *Macomber*, 252 U. S. 189, this Court had before it the question whether stock dividends were income and whether a statute which declared them to be such was valid. The Court held that the statute was invalid, and laid down very definitely the principle that Congress has no power under the Sixteenth Amendment to tax some-

thing as income which is in fact and in substance not income. Thus it was settled for all time that Congress can not arbitrarily call something income and tax it as such if it is not in fact income. So we contend that Congress cannot by arbitrarily fixing a basis for determining gain include in that gain something which in fact and in substance is the capital of the taxpayer. Such a statute is, we submit, unconstitutional and within the inhibition laid down by this Court in *Eisner* v. *Macomber, supra.*

To turn to the specific facts of this case we claim that the petitioner was entitled, in estimating the gain on the sale of her stock, to treat $11,708.80 of its value when she acquired it as a capital investment and not as income on which a tax was payable. Her income in the constitutional sense was the difference between this $11,708.80 and the proceeds of the sale; and Section 202 (a) (2) of the statute, which required her to include this $11,708.80 as income, was unconstitutional.

POINT II.

The Circuit Court of Appeals erred in finding that the provisions of Section 202 (a) (2) of the Revenue Act of 1921 were not capricious and arbitrary and contrary to the Fifth Amendment to the United States Constitution.

That the results of the application of the statute here under consideration are arbitrary and capricious is plain. Let us illustrate: A bought stock for $10. He makes a bona fide gift of it to B after December 21, 1920, when it is worth $100, and B sells the stock for $200. The statute provides that B has a gain of $190. Thus B is given no

benefit whatsoever of the capital which he received at the commencement of his period of ownership and the indirect effect of the statute is that he is taxed on a part of the value of the gift, which the statute provides in another Section (Section 213 (b) (3)) shall not be taxed as income. So far as B is concerned, he has an actual economic gain of $200, but it has long ago been settled that an economic gain is not necessarily a taxable gain in the constitutional sense. *Gould* v. *Gould*, 245 U. S. 151; *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330; *United States* v. *Oregon-Washington R. & Nav. Co., supra.*

In the instant case the result of the statute is that the petitioner is by indirection taxed on the whole value of her gift.

Let us reverse the above example: A bought stock for $200. He gives it to B after December 31, 1920, when it is worth $100, and B, after a year, sells for $10. The statute provides that B has a loss of $190. This is absurd and unreal, because B never had anything worth $190 to lose. The capital asset in his hands never exceeded a value of $100, and that is the most that he could in fact possibly lose, yet the statute allows him a loss of $190. It was just this sort of unreality and disregard of actual facts that this court refused to sanction in *Goodrich* v. *Edwards, supra*, and in the later case of *U. S.* v. *Flannery*, 268 U. S. 98. In the first of these this Court held that a taxpayer could not have a gain unless his sale price exceeded his cost, irrespective of the 1913 value. In the latter case, this Court held that a taxpayer could not have a loss unless his sale price was less than cost, irrespective of March 1, 1913, value. Surely a statute which provides that a taxpayer shall be taxed on an increase which occurred before his ownership, and on the other hand that he shall be entitled to a loss far in excess of any value he ever owned in an asset, is unreal, contrary to fact and

absurd. Its results cannot help but be capricious and arbitrary. Its result was arbitrary in this case. It taxed the petitioner as if she had no capital investment at any time. Unless, then, we are to come to the conclusion that Congress can, in its power to levy income taxes, set any arbitrary basis for determining profit or loss to the taxpayer, with total disregard of the existing and proven facts and to the fixed conceptions of gain and loss as they have become to be known in ordinary custom through long years of business experience, we do not see how this statute can stand.

This Court has said that Congress must not use its taxing power in such an arbitrary and capricious manner as to invade the rights of citizens under the Fifth Amendment to the Constitution (*Frew* v. *Bowers,* 12 Fed. (2) 625; *Coolidge* v. *Nichols,* 274 U. S. 531; *Blodgett* v. *Holden,* 275 U. S. 142). We submit that this is such an instance.

POINT III.

The Circuit Court of Appeals erred in holding that Section 202 (a) (2) of the Revenue Act of 1921 was a legitimate and necessary exercise of the power ancillary to the power to levy taxes.

The Circuit Court of Appeals was evidently influenced in its opinion by the fact that Congress was seeking to supply what was regarded as a weakness in the statute, as evidenced by expressions like the following:

> "The obvious purpose of Section 202 (a) (2) was to prevent the loss of income represented within the profit to the donor during the period he held the property before he made the gift" (R. 17).

* * * * * * *

> "The method of the statute which regards the corpus of the gift, irrespective of its value, as a thing which is transferred is essential to the entire taxing scheme" (R. 18).
>
> • • • • • • •
>
> "That the statute is reasonably ancillary to a valid constitutional purpose seems to me as plain, as in Rice v. Eisner, 16 Fed. (2) 358 (C. C. A. 2); that the practice, if permissible, will become a common contrivance to frustrate that purpose, I have no doubt whatever" (R. 22).

Admittedly the provisions of the above Section were adopted to remedy what was regarded as a weakness in the statute, but we submit that however urgent the need for supplying the omission, the need does not justify an illegal and unconstitutional means. The Sixteenth Amendment authorized Congress to lay and collect taxes on "incomes", and the various Revenue Acts attempt only to levy a tax on "income". To attempt to remedy the situation by adopting a basis for determining gain which is inherently fallacious does not answer the argument that the amount so included is not income (*Eisner* v. *Macomber, supra*). The Circuit Court of Appeals in justifying the means seems to have overlooked this fundamental principle.

Nor is it sufficient to justify the means that the omission might have been closed by other methods of taxation, as, for example, an excise tax on the gift, as suggested by the learned Judges below. It must be remembered that we are here dealing with "income" tax, and that the Sixteenth Amendment sanctions a tax on income only. That another method of supplying the omissions in the statute might have been valid, cannot be relied on to sustain an unconstitutional attempt to levy what was obviously intended to be an income and not an excise tax. Nor is the means justified by saying that the donee

took the property impressed with a tax liability. First of all no income tax liability with respect to the property attached to donor at any time prior to or at the time of the gift (*People ex rel. Wilson* v. *Wendell*, 196 N. Y. App. Div. 596) so there was no liability to pass on. Secondly the argument has been effectively answered by the decision of the court in *Miles* v. *Graham*, 268 U. S. 501. There it was held that a federal judge could not be taxed on his salary contrary to the provisions of the Constitution even though he took the judgeship after the passage of the Revenue Acts and with the knowledge that the Act attempted to tax his salary.

Furthermore in seeking to uphold the Statute the Circuit Court of Appeals has overlooked another well established principle with respect to the Income Tax Law. That principle is, that from the inception of our Federal Income Tax Laws a clear and distinct cleavage has been made between different taxpayers. Such has become settled practice, both in the wording of the laws and in the decisions that have been made under them. The tax is levied on individuals, fiduciaries and corporations (Secs. 210, 219, 230). For instance, the statute draws a very clear distinction between a decedent and his executors as taxpayers and sets them up as separate taxpayers. (See Sections 210 and 219 of the Statute). So, too, the statute is very clear in separating a corporation and its stockholders. (See Sections 201 and 230.) A very recent case on this subject (*Bankers' Trust Co.* v. *Bower*, 23 Fed. (2nd) 941) goes into great detail in drawing this distinction between an executor and a deceased for tax purposes. In other cases it has been held that a legatee is not liable for increase that accrued in the hands of an executor. (*Brewster* v. *Gage*, U. S. Dist. Court, Western Dist. of N. Y., Dec. 27, 1927, unreported; *Ap-*

peal of Mathiessen, 2 B. T. A. 921.) Indeed, this separation into distinct classes of different taxpayers underlies the whole structure of the decisions expounding the theory of realized gain on the sale of capital assets. If any other theory is to be adopted, it can know no bounds, and the person acquiring property can never tell what liability he assumes in the way of income tax if any basis entirely foreign to him can be arbitrarily adopted for determining his gain. It is this fact that no doubt underlies the attempt in the statute and the trend in the decisions always to draw a distinct line between separate taxpayers. If a decedent and his executor or a deceased and his legatees must be dealt with separately, surely there is no justification for confusing the identity of a donor and a donee and treating them as one. Indeed, the legal status of an executor is much more closely identified with the decedent than that of the donor with the donee. So we submit that in determining this gain the court must be concerned "with whose income it is" (R. 21) in the words of one of the Justices of the Circuit Court of Appeals, and that any decision which ignores this principle is not sound.

Respectfully submitted,

CADWALADER, WICKERSHAM & TAFT.

HENRY W. TAFT,
CLARENCE CASTIMORE,
of Counsel.

LAWYERS PRESS, INC., 165 WILLIAM STREET, NEW YORK CITY, N. Y.

FILE COPY

APR 25 1928
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1927

No. 554 / 16

ELIZABETH C. TAFT, *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR PETITIONER

Supreme Court of the United States

October Term, 1927

No. 554

ELIZABETH C. TAFT, *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

INDEX

ARGUMENT:

PAGE

1. A casual gift of property is not income to the donee upon receipt 1
2. The donee does not step into the shoes of the donor with notice 6

CITATIONS.

CASES:

Edwards v. Cuba R. R. Co., 268 U. S. 628 5

Gould v. Gould, 245 U. S. 151 4

Ruling of Commissioner, 7 Int. Rev. Record 59 5

Smietanka v. First Trust and Savings Bank, 257 U. S. 602 4

U. S. v. Oregon-Washington R. & Nav. Co., 251 Fed. 211 5

STATUTES:

Revenue Act of 1921, 42 Stat. 227, Sec. 213 (b) 3

Revenue Act of 1924, 43 Stat. 253, Sec. 213 (b) 3

Revenue Act of 1926, 44 Stat. 9, Sec. 213 (b) 3

Supreme Court of the United States

October Term, 1927

No. 554

ELIZABETH C. TAFT, *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

REPLY BRIEF FOR PETITIONER.

The pith of the Respondent's argument to support the constitutionality of this statute may be briefly summarized as follows:

(1) A gift is in its intrinsic nature "income" and is therefore constitutionally taxable to the donee in whole or in part when received.

(2) Congress can constitutionally postpone levying the tax until conversion at a later date, that is, until such time as the corpus of the gift is sold or disposed of by the donee.

With these premises we cannot agree. The burden of the Respondent's argument is that the corpus of a gift is income because, (a) "in the ordinary sense of the word and as it is used in common speech, the word 'gift' conveys the meaning of true income to the donee" (page 11,

Respondent's brief); and (b) it is to be inferred from the language of the Federal and several state income tax statutes which exempts gifts from taxation, that a gift is in its intrinsic nature, income.

Do these statements stand the test of analysis? Would it, in the words of the Respondent's brief (page 11), "surprise the man in the street, for whom the tax laws are intended, to be told that if he received a gift under the circumstances of these cases he would not have made a gain nor be in receipt of income." But would it not cause greater surprise in a bride who receives a wedding gift of $200,000 from her father to provide her with some separate means and income to be told that such gift is a part of her income; or would it not surprise a business executive who is unexpectedly given a bonus at New Years to be warned that he must regard the amounts, however large, as a part of his income; or can it be said that a baseball hero who is presented with an automobile at the end of the season by his admirers, must regard the car as a part of his income? More striking still, is the case of one who receives a legacy of personal property or a devise of land. Can it be said that the man in the street who receives it would regard it as a part of his income? Indeed, we venture to say that such a person would be very much surprised if he were to be informed that the legacy or the devise *was* a part of his income. Yet that a gift and a legacy were regarded in the same category by Congress seems very clear from the fact that they are grouped together in the very same exemption clause in the income tax acts, not only in the Federal Income Tax Act, Section 213 (b) (3), (page 5 our main brief), but also in the various state acts. We suggest, therefore, that it is certainly too broad a generalization to conclude

that all gifts—especially casual gifts of the nature of the one here under consideration—are in common speech and understanding regarded as income to the recipient. The Respondent's conclusions are scarcely supported by the facts.

The Respondent next seeks to draw from the exemption clauses in the Federal and state income tax statutes the inference that Congress and the Legislatures regard gifts as intrinsically income. The argument is far from conclusive. For instance, the Respondent quotes from Section 4 of the Revenue Act of 1916 as amended (page 13, Respondent's brief), as follows:

> "SEC. 4. The following *income* shall be exempt from the provisions of this title: * * * the value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included as income); * * * (Italics ours.)"

In the first place that Congress has referred to something as "income" does not make it so. Respondent fails to mention the language found in all of the later acts covering the same subject which provides as follows:

> "The term 'gross income' does not include the following *items* which shall be exempt from taxation under this title * * *.
>
> (3) The value of property acquired by *gift*, bequest, devise or inheritance * * *." (Italics ours.)

(Section 213, (b), (3), Revenue Act, 1921, 1924, 1926.)

Obviously, the purpose of these clauses was to see to it that a gift should not be taxed to the donee when received. That accomplished, we do not believe that it is

to be presumed that Congress gave any deep and laborious thought to the question whether a gift is intrinsically income. Certainly one should not rely on the vagaries of the wording of our many recent revenue laws to draw such an important inference unless there is a legislative history to prove that the language was adopted with such a purpose and there appears to be no such in respect to these clauses.

It seems to us that a pertinent question in this connection is this. If Congress was convinced that a gift is intrinsically income, why did it resort in the Revenue Act of June 2, 1924, Sections 319-324, to an excise tax upon gifts *inter vivos* as a source of revenue? It would have been far simpler to have omitted the word "gift" from Section 213 (b) (3) and levied an income tax upon them and unquestionably the revenue derived would have been much greater.

In this connection, Respondent quotes at page 12 of his brief, from *Rice* v. *Eisner,* 16 F. (2) 358, as follows:

> "The exemption in all the statutes of the corpus of gifts and bequests shows that in the minds of those who drew the acts it was thought open to question whether even this might not be considered income."

This proves too much. It admits of doubt, and in all cases of doubt the statute is to be resolved in favor of a taxpayer.

> *Gould* v. *Gould,* 245 U. S. 151;
> *Smietanka* v. *First Trust and Savings Bank,* 257 U. S. 602.

The Respondent admits his inability to find any decision holding that the corpus of a gift is intrinsically

income but trusts to general inferences from common usage and from the wording of the statutes. As against this we offer the following rulings and cases under the income tax laws which are certainly entitled to weight. Under the Income Tax Act of 1862 the Commissioner of Internal Revenue ruled as follows:

> "Gifts of money, when clearly not in the nature of payment for services rendered, or for other valuable consideration, are not liable to taxation as income" (7 Internal Revenue Record 59).

In *U. S.* v. *Oregon-Washington R. & Nav. Co.*, 251 Fed. 211, a creditor forgave indebtedness of approximately six million dollars. The Court held that this did not constitute income to the debtor. The effect of the transaction was exactly the same as if the creditor had handed to the debtor as a gift the amount of the indebtedness and said, "Now pay me what you owe me." It was clearly a gift. See also *Edwards* v. *Cuba R. R. Co.*, 268 U. S. 628. The weight of opinion as thus far expressed is certainly on the side of the argument that the corpus of a gift is not intrinsically income.

Finally, on this point we again invite your attention to the definition of income (page 7, our main brief) adopted and repeatedly followed by this Court. How can the corpus of a gift be gain derived *from* capital, *from* labor, or from *both* combined, of the donee, or from a conversion of capital assets? There is no such conversion.

We submit that the corpus of a casual gift of this sort is not intrinsically "income" to the donee within the meaning of the Sixteenth Amendment of the Federal Constitution. It is, therefore, a capital transaction.

There is one more argument of the Respondent to which we wish to invite attention. On page 24 of the Respondent's brief, he quotes from the case of *U. S.* v. *Phellis,* 257 U. S. 156, as follows:

> "In buying at a price which reflected the accumulated profits, he of course acquired as a part of the valuable rights purchased the prospect of a dividend from the accumulations—bought 'dividend on,' as the phrase goes—and necessarily took subject to the burden of the income tax proper to be assessed against him by reason of the dividend if and when made. He simply stepped into the shoes, in this as in other respects, of the stockholder whose shares he acquired, and presumably the prospect of a dividend influenced the price paid, and was discounted by the prospect of an income tax to be paid thereon."

The above language was used by this Court in response to the argument that the tax in that case was a tax on capital. The Respondent draws from this language the conclusion that the donee in the same way steps into the shoes of the donor. The analogy is far from perfect. When an investor purchases, presumably he looks into all of the surrounding facts concerning the securities that he proposes to buy and is on notice. This, however, is not true of the donee of a casual gift. To use an expressive colloquialism, "one does not look into the mouth of a gift horse." The donee of the casual gift makes no opportunity to search into the past history and facts surrounding the property which is the subject of a gift. That generally is of no concern to him and he would be embarrassed by inquiring about it. He may step into the shoes of the donor in some respects, but he certainly

does not generally do so with notice of the past facts concerning the property as does the investor and he should not be charged with such notice.

Respectfully submitted,

CADWALADER, WICKERSHAM & TAFT.

HENRY W. TAFT,
CLARENCE CASTIMORE,
of Counsel.

FILE COPY

OCT 6 1928

CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1927

No. 5[redacted] 16

ELIZABETH C. TAFT, *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

SUPPLEMENTAL BRIEF FOR THE PETITIONER

CADWALADER, WICKERSHAM & TAFT.

HENRY W. TAFT,
CLARENCE CASTIMORE,
of Counsel.

INDEX

PAGE

A—A gift is not income 2

Argument for the Petitioner 3

(a) Etymological 3

(b) Income in its "Ordinary Sense" or in "Common Speech" 5

B—A gift is not income within the definition approved by this Court 9

C—It was not the intention of Congress to give to the amended Section 202 (a) (2) of the Revenue Act a retroactive effect so as to take account of increase in the value of the gift accruing prior to the passage of the law 10

TABLE OF CASES.

American and English Enc. of Law 2

Doyle v. Mitchell Bros. Co., 247 U. S. 179 ..... 4, 9

Eisner v. Macomber, 252 U. S. 189 ..... 4, 5, 8

Irwin v. Gavit, 268 U. S. 161 7

Merchants Loan & Trust Co. v. Smietanka, 255 U. S. 509 ..... 4, 5

Rice v. Eisner, 16 Fed. 2nd 358 11

Shwab v. Doyle, 258 U. S. 529 10

Stratton's Independence v. Howbert, 231 U. S. 399 ..... 4, 9

Sutherland, Statutory Construction, § 216 2

United States v. Oregon-Washington R. & Nav. Co., 251 Fed. 211 5

White v. United States, 191 U. S. 545 10

Supreme Court of the United States

October Term, 1927

No. 554

ELIZABETH C. TAFT, *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York, *Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

SUPPLEMENTAL BRIEF FOR THE PETITIONER

This brief is filed to show:

(1) That no part of a gift constitutes, within the meaning of the Sixteenth Amendment, income of a donee; and

(2) That it was not the intention of Congress to give to Section 202 (a) (2) of the Revenue Act of 1921 a retroactive effect so as to take account of increase in the value of the gift accruing prior to the passage of the law.

A.

A gift is not income.

The Government's argument is:

(a) In "ordinary sense" and in "common speech" a gift is income. Congress regarded it as such because it specifically provided that it should be exempted from gross income.

(b) If the entire value of the gift is taxable, a part of it, to-wit, the enhancement of its value from the time the donor acquired it, is taxable.

This narrows the controversy to the question whether a gift is income within the meaning of the 16th Amendment.

Preliminarily, it may be said that Congress cannot by legislation convert into income what is not income. Furthermore, the proviso relied upon by the government, that the value of property acquired by gift should be exempt from taxation, has no such effect as that claimed. The office of a proviso is to "remove possible obscurities that might otherwise exist and render the law more precise" (Sutherland, Statutes and Statutory Construction, § 216) or "to exclude some possible ground of misinterpretation of it, as extending to cases not intended by the legislature to be brought within its purview." (*American & English Enclopaedia of Law,* 2nd edition, p. 678, quoted in *Matter of Hoss,* 59 Washington, 360). It is quite natural that Congress should intend to remove any ambiguity upon the subject of what was and what was not income, since it has excited so much controversy and difference of opinion among lawyers and the courts. No reasonable argument, therefore, can be based upon the exemption referred to.

Argument.

Neither in "common speech" nor in the "ordinary sense" is a gift income.

1. That it is a "gain" does not settle the question, for the 16th Amendment refers only to "incomes", and we are, therefore, thrown back to the question, what is an "income"?

2. The word "income" does not in any of its uses or any of its meanings, direct or derivative or implied, include a gift.

This question should be considered by looking at it from a variety of viewpoints, even though from no one of them alone is a conclusion to be drawn. A correct definition will result from a composite view:

(a) Etymological:

The New Standard Dictionary gives the meaning of "income" as follows:

> "The amount of money coming to a person or corporation within a specified time or regularly (when unqualified, annually), whether as payment for services, interest from investment; revenue."

None of the other meanings given to the word depart in essence from the foregoing definition.

The meaning given for the word "capital" gives the relation between "capital" and "income" as follows:

> "(1) The property used in the business of a firm or corporation at a valuation on which profits or dividends are calculated. * * *
>
> "(3) The amount of property owned by an individual or corporation at a specified time, as distinct from the income received during a given period."

The definition in the Oxford Dictionary of "income" is as follows:

> "That which comes in as the periodical produce of one's work, business, lands, or investments (considered in reference to its amount, and commonly expressed in terms of money): annual, or periodical receipts accruing to a person or corporation."

From these definitions it is to be noted:

(1) Income comes to a person "within a specified time" or "regularly", or is the "periodical produce" or the "annual, or periodical receipts." This language would exclude a gift or a legacy or an inheritance, all of which are casual, come without regularity, or in the case of capital increase, during a definite period.

(2) Income must be "as payment for services, interest from investment; revenue", or "produce of one's work, business, lands, or investments."

While the definition of income has been extended by the Income Tax Law and the decision of this Court in *Merchants Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509, so as to include accretion to capital, that decision was rendered with reference to an accretion which was a realized "gain or profit", "produced by" or "derived from" an *investment;* but the words used in *Stratton's Independence* v. *Howbert* (231 U. S. 399, 415), and applied in *Doyle* v. *Mitchell Bros. Co.* (247 U. S. 179, 185), which were approved as to the Income Tax Law in *Eisner* v. *Macomber* (252 U. S. 189), and *Merchants Loan & Trust Co.* v. *Smietanka* (255 U. S. 509), do not affect the essen-

tial features of an income that it (1) must be the product of invested capital or labor or services, and (2) must be reckoned for regular periods (annually, if not specified otherwise), or within some definite or specified period, as, for instance, the period during which a realized gain upon an investment is to be measured.

(b) Income in Its "Ordinary Sense" or in "Common Speech".

We quote some expressions of the courts upon this subject:

Justice Holmes in his dissenting opinion in *Eisner* v. *Macomber, supra,* said that income should be read " 'in a sense most obvious to the common understanding at the time of its adoption.' "

Justice Clark in *Merchants Loan & Trust Co.* v. *Smietanka, supra,* said income should be given the "commonly understood meaning" in the minds of the people.

Judge Learned Hand, for the Circuit Court of Appeals for the Second Circuit, in *United States* v. *Oregon-Washington R. & Nav. Co.,* 251 Fed. Rep. 211, used the following language:

> "Yet the word unquestionably imports, at least so it seems to us, the current distinction between what is commonly treated as the increase or increment from the exercise of some economically productive power of one sort or another and the power itself, and it should not include such wealth as is honestly appropriated to what would customarily be regarded as the capital of the corporation taxed.
>
> • • • • • •
>
> We regard the difference as precisely equivalent to the difference between the cancellation of a portion of the mortgage bonds and a cancellation

> of an equal proportion of their coupons. Common usage would, if we are right, unfailingly allocate the first as an increase in capital assets and the second as an increase in income. That, as we view it, is the proper test of the act."

We will consider the meaning of income in "common speech" in a number of relations. But first, what is "common speech"? It must be presumed that it is the speech which members of Congress consider appropriate to express their meaning. That involves the exercise of some intelligence and experience. A meaning ought not to be given to a statutory expression because the ignorant, the uneducated and the inexperienced would give it that meaning. We do not look to persons in the community, however numerous, for a definition of a word defining something which they have never had occasion to deal with. This is a reasonable position from which to consider the significance of income in what the court has called "common speech."

(1) *The Man in the Street:* He would regard a gift, a legacy, a devise or an inheritance as a windfall—as a nest-egg to be added to his savings. Any individual member of Congress with business experience, would also regard it in that light.

(2) *Economists* (as quoted in the opinion in *Eisner* v. *Macomber*): Capital is "likened to the tree or the land", income "to the fruit or the crop"; capital as the "reservoir supplied from springs", income "as the outlet stream, to be measured by its flow during a period of time."

(3) *Accountants and Businessmen:* Clearly a gift would be treated as an accretion of capital. For instance,

a father puts a son in a business firm and presents him with a sum of money for that purpose. It goes into the capital account of the son, and usually he is allowed interest upon it, which, of course, is his income. A father pays for a son's seat in the Stock Exchange, the seat to be used for the business of a firm which the son enters. The amount paid for the seat, of course, goes to the capital account of the son.

(4) *Contribution of a Stockholder to a Corporation:* A stockholder contributes stock or bonds or cash in order to increase the value of the stock he continues to hold. The contribution increases the assets of the corporation and would, of course, go into its capital account.

(5) *Legacy or Inheritance:* This stands on the same footing as a gift. A legatee or an heir-at-law or next of kin, ordinarily treats a legacy or an inheritance as capital, and if he impairs it in using it, he is regarded as improvident, for it generally represents the accumulation of the ancestor. If a legacy is given to trustees, it is treated as capital on every principle of accounting and law.

In *Irwin* v. *Gavit,* 268 U. S. 161, 166, the effort was made to have a direct bequest of installments of income of a fund left by will in trust, given the character of principal, and, therefore, not subject to the income tax. It was held that the installments were not bequests, but income, "within the meaning of the statute and the Constitution, and by popular speech." Justice Holmes said

> "But we think the provision of the act that exempts bequests assumes the gift of the *corpus* and contrasts it with the income arising from it, but was not intended to exempt income properly

> so called simply because of a severance between it and the principal fund."

Does not this language apply to a gift *inter vivos?* We submit that it does. The statute assumes the gift of the *corpus* and makes the contrast with the income. This contrast results from a fundamental difference. The *corpus* is the entire value of the gift, and Sec. 202 (a) (2) cannot change what was a component part of it from capital into income, whatever the intention was, any more than the testator could by will change what was income into capital. If the gift had been by will to trustees upon a valid trust, they would have been obliged in any probate court to set up the trust at the value at the time that they received it as capital.

This is, as was said in *Eisner* v. *Macomber,* "according to truth and substance, without regard to form." And it is added:

> "Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised."

B.

A gift is not income within the definition approved by this Court.

A definition of income was first given under the Corporation Tax Law of 1909 in *Stratton's Independence* v. *Howbert* (*supra*); *Doyle* v. *Mitchell Bros. Co.* (*supra*). It was:

> "Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets."

This definition was adopted by the Court in *Eisner* v. *Macomber*, in the words, "we find little to add to the succinct definition adopted" in those two cases. The only amplification of the definition made by this court was made in the *Doyle* case to the effect that it conveyed "the idea of gain or increase arising from corporate activities" and that it imports "something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax." This definition is predicated on the taxable income being produced by labor or services of the taxpayer, or proceeding from the use of property; as was said in the *Macomber* case, it is not mere "gain" or accession, it must be a gain or accession "derived" or proceeding from existing capital, presumably capital in which the taxpayer has an interest as owner or otherwise. A gift does not proceed from capital nor is it derived from capital or labor or both capital and labor combined. It simply comes to the taxpayer without labor on his part and without the use of his capital.

C.

That it was not the intention of Congress to give to the amended Section 202 (b) (3) of the Revenue Act a retroactive effect so as to take account of increase in the value of the gift accruing prior to the passage of the law.

We suggest that Section 202 (a) (2) of the Revenue Act of 1921 may be so interpreted as to grant relief to this petitioner and at the same time avoid an unconstitutional result.

It is an established rule of statutory construction that if two interpretations are possible, the Court will adopt the one that avoids an unconstitutional result. It is equally well established that this Court will not adopt an interpretation which gives a retroactive effect to a statute, unless the language is so clear, strong and compelling that such an interpretation is imperative. *Shwab* v. *Doyle*, 258 U. S. 529; *White* v. *United States*, 191 U. S. 545.

As applied to the present petitioner, the interpretation placed by the Circuit Court of Appeals on Section 202 (a) (2) of the Revenue Act of 1921 has a retroactive effect. The donor acquired the stock, which was the subject of the gift, in the year 1916 (Rec. 4). He gave part of it to the petitioner in December, 1921, and part in January, 1922. The parties have agreed that the value of the stock as of the date of gift was $11,708.80 (Rec. 4). The record also accepts the cost to the donor in 1916 as zero (Rec. 4). Therefore it follows that since the statute as interpreted by the Court below has taxed the full amount

of the proceeds of the sale to the petitioner, it has reached back and taxed an increment which occurred prior to December 31, 1920, and prior to the date of the passage of the Revenue Act of 1921, which was November 23, 1921; and the statute would necessarily have the same effect in every case where the acquisition of the property by the donor was prior to the date of the Act and the increment occurred prior to that time. We insist that the language of Section 202 (a) (2) is not sufficiently strong and clear to compel such a construction, and we suggest that a proper interpretation of the section is that it applies only in those cases where the donor acquired the property subsequent to December 31, 1920, and the gift was made after that date. So interpreted, the statute is given a reasonable effect and does not reach an increment that accrued prior to the passage of the Act.

The fact that under the foregoing interpretation the statute provides no basis for determining gain or loss in the present case ought not to cause any difficulty, for prior to the Revenue Act of 1921 there was no provision in any of the Income Tax Acts fixing a basis for determining the gain or loss on the sale of property acquired by gift. The Department found no difficulty under the wording of the statutes in providing by regulation that the basis should be the fair market value on the date of acquisition (U. S. Treasury Regulations 33, Rev. Art. 4; U. S. Treasury Dept. Regulations 45, Art. 1562, issued under the Income Tax Acts prior to 1921), and this position of the Department has been upheld by the courts. *Rice* v. *Eisner* (16 Fed. 2d, 358). Such a ruling is as reasonable now as it was then, and we see no reason for not

adopting it in cases like the present, or in other proper cases that may not be strictly within the wording of the section as interpreted above.

Respectfully submitted,

CADWALADER, WICKERSHAM & TAFT.

HENRY W. TAFT,
CLARENCE CASTIMORE,
of Counsel.

[1485]

LAWYERS PRESS, INC., 165 WILLIAM ST., NEW YORK CITY, N. Y.

FILE COPY

CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1927

No. 575/17

GILBERT C. GREENWAY, JR.,

Petitioner,

v.

FRANK K. BOWERS, Collector of United States Internal Revenue for the Second District of the State of New York,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO REVIEW THE DECISION OF THE UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT, AND BRIEF IN SUPPORT OF PETITION.

Constitutionality of Section 202 (a) (2), Revenue Act, 1921 (42 Stat. 227). The question presented by this petition is whether the provision of the above Act, which required a donee to use the cost of the property to the donor as a basis for computing profit for income-tax purposes, was unconstitutional in so far as it taxed to the donee, as income, increment in the value of a gift which accrued prior to its acquisition by the donee.

ROGER S. BALDWIN,
Counsel for Petitioner,
120 Broadway,
New York, N. Y.

LAWYERS PRESS, INC., 165 WILLIAM STREET, NEW YORK CITY, N. Y.

INDEX

PAGE

Petition 1

Brief 7

I. An entirely new principle in Income Tax Law of vital importance to every taxpayer who has sold or may hereafter sell property acquired by gift is involved 8

II. It was error to hold that the increase in value which accrued during the time the stock was held by the petitioner's donor was income taxable to the petitioner 9

III. It was error to hold that Congress could enact Section 202 (a) (2) of the Revenue Act of 1921 in the exercise of its general power to levy taxes 11

Conclusion 13

Cases Cited.

Edwards v. Cuba R. R. Co., 268 U. S. 628 10

Eisner v. Macomber, 252 U. S. 189 9

Goodrich v. Edwards, 255 U. S. 527 9

Gray v. Darlington, 82 U. S. 63 9

Lynch v. Turrish, 247 U. S. 221 9

Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509 9

Towne v. Eisner, 242 Fed. 704 10

Supreme Court of the United States

October Term, 1927

GILBERT C. GREENWAY, JR.,
Petitioner,

v.

FRANK K. BOWERS, Collector of United States Internal Revenue for the Second District of the State of New York,
Respondent.

PETITION OF DEFENDANT IN ERROR FOR A WRIT OF CERTIORARI TO REVIEW THE DECISION OF THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Supreme Court of the United States:

The petition of Gilbert C. Greenway, Jr., the defendant in error below, respectfully shows:

I. That this is an action at law brought in the United States District Court for the Southern District of New York to recover $4,441.61, income tax, paid under protest by the petitioner to the respondent for the calendar year 1922.

II. Said action for such recovery was brought on the ground that Section 202 (a) (2) of the Revenue Act of

1921 (42 Stat. 227), under which such tax was imposed, is in violation of Subdivision 4, Section 9 of Article I of the Constitution of the United States and of Article XVI of the amendments thereto, and is also in conflict with other provisions of the same Revenue Act.

III. The respondent moved in the District Court to dismiss the complaint on the ground that it failed to state facts sufficient to constitute a cause of action. Said motion was denied, the learned District Court holding that Section 202 (a) (2) of the Revenue Act of 1921 in so far as it attempts to tax as income to the donee, upon its subsequent sale by the latter, the increase in value of the corpus of a gift over its original cost while held by the donor, was unconstitutional.

IV. On appeal to the Circuit Court of Appeals for the Second Circuit, the judgment of the District Court was reversed by a divided court, Judges Manton and Hand voting for a reversal and Judge Swan voting for an affirmance of the judgment of the District Court. The order on mandate reversing the judgment of the District Court was entered on the 13th day of July, 1927.

V. Ninety (90) days have not elapsed since the entry of the said order in accordance with the decision of said Circuit Court of Appeals.

VI. The petitioner respectfully moves this Court for a Writ of Certiorari to review the said decision of the Circuit Court of Appeals for the Second Circuit.

VII. The case of the petitioner is based on the following facts, concerning which there is no dispute:

During 1921 and 1922, plaintiff's brother, John C. Greenway, owned 10,000 shares of Ahumada Lead Com-

pany stock for which he had paid $10,000. On March 29, 1921, he made a gift to the petitioner of 5,000 shares of such stock, the market value of which at that time was $13,750. On March 1, 1922, he gave the remaining 5,000 shares to the petitioner, the market value of which at that time was $16,250. On August 1, 1922, petitioner sold the 10,000 shares for $52,500 and solely in obedience to the provisions of Section 202 (a) (2) of the Revenue Act of 1921, which provides:

> "(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that * * *
>
> (2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor, or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

petitioner reported in his Income Tax return for 1922, a profit of $42,500 on the sale of the stock, which amount was the difference between the cost of the stock to the petitioner's donor and the amount for which the petitioner sold the same.

Petitioner paid the tax thereon protesting, however, that so much of said tax, to wit: $4,441.61, as was assessed on the increase in value of the stock during the time it was owned and held by the petitioner's donor, was assessed unlawfully and in violation of the provisions of the Constitution of the United States.

VIII. Thereafter and on March 27, 1924, petitioner filed a claim for refund of said $4,441.61 and after the expiration of six months thereafter this action was commenced in the District Court in which the question of the constitutionality of the provisions of Section 202 (a) (2), above set forth, was raised.

IX. For the reasons set forth in the annexed brief, your petitioner believes that the decision of the Circuit Court of Appeals was erroneous and contrary to law, and that this honorable Court should require the case to be certified to it for review and determination in conformity with the Acts of Congress in such case made and provided.

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari may issue out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding the said Court to certify and transmit to this Court, on a day to be therein designated, a full and complete transcript of the record and all proceedings of the said Circuit Court of Appeals in the said case therein, entitled "Frank K. Bowers, Etc., Plaintiff in Error, v. Gilbert C. Greenway, Jr., Defendant in Error, (No. 294)," to the end that the case may be reviewed and determined in this Court, as provided by Section 240 of the Act of Congress designated as the Judicial Code, and that the said judg-

ment of the said Circuit Court of Appeals in this case and every part thereof may be reviewed by this honorable Court and that the judgment of the District Court be confirmed and that such other and further relief be granted as to the Court shall seem just and equitable and in conformity with the law.

GILBERT C. GREENWAY, JR.,
Petitioner.

ROGER S. BALDWIN,
Counsel.

STATE OF NEW YORK, }
COUNTY OF NEW YORK, } ss.:

GILBERT C. GREENWAY, JR., being duly sworn, says that he is the petitioner named in the foregoing petition, and that he has read the same, and that the allegations thereof are true, as he verily believes.

GILBERT C. GREENWAY, JR.

Subscribed and sworn to before me }
this 30th day of September 1927. }

M. PHILIP,
Notary Public, Kings County,
Kings Co. Clks. No. 287, Reg. No. 9089,
N. Y. Co. Clks No. 133, Reg No. 9133,
Commission expires March 30, 1929.

IN THE

Supreme Court of the United States

October Term, 1927

GILBERT C. GREENWAY, JR.,
Petitioner,

v.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

BRIEF IN SUPPORT OF PETITION.

Statement.

This action was commenced by the petitioner in the United States District Court, Southern District of New York, to recover $4,441.61, income tax, paid in the year 1923. The opinion of the District Court is reported in 15 Fed. (2) 890. Judgment was entered for the petitioner on September 10, 1926 (R. 23-25). The Circuit Court of Appeals reversed the judgment of the District Court. The opinions of the Circuit Court of Appeals are reported in 20 Fed. (2) 561. The order reversing the judgment of the District Court was filed July 13, 1927 (R. 42). In the proceeding below the petitioner claimed that the increment in the value of certain stock, to wit, $20,000, which accrued prior to his ownership was not

income, (R. 7), and, hence, the statute which taxed it as such was unconstitutional (R. 8). The petitioner relies upon Section 240 of the Judicial Code as authority for the jurisdiction of this Court. All of the material facts are set forth in Paragraph VII of the Petition and on Pages 4-8 of the Record. The errors to be urged are specifically set forth in Points 2 and 3 of this brief.

1. This case involves an entirely new principle in income tax law and is of vital importance to every taxpayer who has sold or may hereafter sell property acquired by gift.

Section 202 (a) (2) of the Revenue Act of 1921, quoted in the foregoing petition, requires every donee of property, received after December 31, 1920, to use as the basis for determining the gain or loss on a subsequent sale of the property the cost to the donor or the last preceding owner by whom it was not acquired by gift.

Similar provisions are contained in Section 204 (a) (2) of the Revenue Act of 1924 and in Section 204 (a) (2) of the Revenue Act of 1926 so that the question involved in this case is of very present interest.

The Section above referred to is in direct conflict with Section 213 (b) (3) of the same Act (Revenue Act of 1921) which provides that gross income does not include the value of property acquired by gift.

So far as counsel for petitioner has been able to discover the question involved in this case has never been presented to this Court and has never been determined by any Court except in this case, and the kindred case of Elizabeth C. Taft against Frank K. Bowers, Collector, which was heard and decided by the District Court and Circuit Court of Appeals at the same time as the present case.

The Circuit Court of Appeals by a divided Court sustained Section 202 (a) (2) as a valid legislative enactment. Judge Swan dissented and agreed with District Judge Knox that the statute was unconstitutional. Each of the three Judges of the Circuit Court of Appeals wrote a separate opinion, and Judge Knox also rendered an opinion in the District Court. The opinions which are printed in the Record which accompanies this application show the diversity of reasoning upon which the four Judges of the Courts below based their conclusions.

Section 202 (a) (2) introduced an innovation in income tax legislation, the validity of which it is respectfully submitted should be finally determined by this Court.

2. The Circuit Court of Appeals erred in holding that the increase of $20,000 in the value of the stock which accrued during the time it was held by the petitioner's donor was income taxable to the petitioner.

This Court has consistently held that the increase in value of capital does not constitute income.

Gray v. *Darlington*, 82 U. S. 63;
Lynch v. *Turrish*, 247 U. S. 221.

This Court has defined income to be

> "The gain derived from capital, from labor, or from both combined, provided it is understood to include profit gained through a sale or conversion of capital assets."
>
> *Eisner* v. *Macomber*, 252 U. S. 189, 207;
> *Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 518;
> *Goodrich* v. *Edwards*, 255 U. S. 527, 535.

Amplifying the above definition, Mr. Justice Pitney said further in *Eisner* v. *Macomber, supra,* at page 207 that income is

> "*not* a gain *accruing* to capital, nor a *growth* or *increment* of value *in* the investment."

In *Edwards* v. *Cuba R. R. Co.,* 268 U. S. 628, this Court held that the value of physical properties and money given by the Cuban Government to the railroad company by way of subsidy was not income within the meaning of the Sixteenth Amendment.

The fact that Congress expressly declared the increase in value during the ownership of the donor to be income of the donee upon the subsequent sale by the latter does not make such increase income if in fact it is not such.

In *Eisner* v. *Macomber, supra,* this Court quoted with approval the following language from the opinion of Judge A. N. Hand in *Towne* v. *Eisner,* 242 Fed. at page 704:

> "It is manifest that the stock dividend in question cannot be reached by the Income Tax Act, and could not, even though Congress expressly declared it to be taxable as income, unless it is in fact income."

3. The Circuit Court of Appeals erred in holding that Congress in the exercise of its general power to levy taxes could enact Section 202 (a) (2) of the Revenue Act of 1921.

Judge Manton in his opinion said—

> "But the question is whether the method adopted by Congress for measuring income is, in

> the case of the donee, a reasonable one in the aid of purposes of Federal income taxation. * * *
>
> "The method of the statute which regards the corpus of the gift, irrespective of its value, as a thing which is transferred is essential to the entire taxing scheme. * * *
>
> "The statute may, indeed, be said to be an execution of the main design of the income-tax Act."

Judge Hand in his opinion said—

> "That the statute is reasonably ancillary to a valid constitutional provision seems to me as plain as in *Rice* v. *Eisner*, 16 Fed. (2) 353."

Again, Judges Manton and Hand attempt to support their conclusions by pointing out that the same result might have been obtained by the levy of an excise tax. In this connection Judge Manton stated—

> "No one would have doubted the power of Congress to impose a tax upon the donor at the time of the gift and the tax could have been measured by the difference between the price paid for it and its value when he transferred it. Nor could it be criticised if the donee was left to pay the balance of the tax based upon the difference between the value on the date of acquisition and the value on the date of sale."

Judge Hand stated:

> "Therefore there is a subject-matter which Congress may tax without apportionment and part of which, after *Eisner* v. *Macomber*, it could not tax in any other way, except, perhaps, as an excise."

This reasoning ignores completely the fundamental principle that property obtained by gift is capital, not

income, in the hands of the donee, and that under the Sixteenth Amendment Congress can only tax without apportionment among the states that which is in fact income. The majority opinions also fail to take into account the distinction made in the Constitution between direct taxes and excise taxes. It does not follow that because Congress can impose an excise tax without apportionment upon the exercise of certain rights and privileges it can lay a direct tax upon the subject matter involved in the exercise of such rights and privileges without apportionment.

The principles which control in this case are stated clearly and correctly by Judge Swan in his dissenting opinion, as follows:

> "It has been established that Congress may not tax as income what in fact is not income, without apportioning the tax according to the constitutional requirement. *Eisner* v. *Macomber*, 252 U. S. 189. Property obtained by gift is capital, not income in the hands of the donee upon its receipt. *Edwards* v. *Cuba Railroad*, 268 U. S. 628; *United States* v. *Oregon-Washington & Co.*, 251 F. 211 (C. C. A. 2). * * *
>
> "The tax is not an excise on the privilege of accepting the gift; it is an income tax, and the taxpayer's income must be a gain derived from *his* capital, or *his* labor, or from both combined."

Conclusion.

WHEREFORE, the petitioner respectfully prays that this Court take jurisdiction of this question because:

1. This case involves an entirely new principle of income tax law and is of vital importance to every taxpayer who has sold or may hereafter sell property acquired by gift.

2. The Circuit Court of Appeals erred in holding that the increase of $20,000 in the value of the stock which accrued during the time it was held by the petitioner's donor was income taxable to the petitioner.

3. The Circuit Court of Appeals erred in holding that Congress in the exercise of its general power to levy taxes could enact Section 202 (a) (2) of the Revenue Act of 1921.

ROGER S. BALDWIN,
Counsel for Petitioner,
120 Broadway,
New York, N. Y.

Supreme Court of the United States

October Term, 1927

GILBERT C. GREENWAY, JR.,
Petitioner,

v.

FRANK K. BOWERS, Collector of United States Internal Revenue for the Second District of the State of New York,
Respondent.

No.

Sir:

PLEASE TAKE NOTICE that I have filed in the Supreme Court of the United States a petition for a writ of certiorari in this cause, a copy of the record and a brief, of which copies are hereto annexed and herewith served upon you. Pursuant to Subdivision (4) of Rule 35 of the Supreme Court, the said petition, record and brief will be submitted to the Court on the first motion day following the expiration of twenty days after service of this notice upon you.

Dated, New York, October 4, 1927.

ROGER S. BALDWIN,
Attorney for Petitioner,
120 Broadway,
New York, N. Y.

To:
Hon. WILLIAM D. MITCHELL,
Solicitor General,
Washington, D. C.

Due service of the foregoing notice and the annexed petition, record and brief are hereby acknowledged.

October , 1927.

Attorney for Respondent.

FILE COPY

FILED
APR 26 1928
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1927

No. ~~575~~ 17

GILBERT C. GREENWAY, JR., *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR PETITIONER

Supreme Court of the United States

October Term, 1927

No. 575

GILBERT C. GREENWAY, JR., *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

INDEX

	PAGE
Statement	1
Argument	2
CITATIONS.	
Doyle v. Mitchell Brothers Company, 247 U. S. 179	5
Eisner v. Macomber, 252 U. S. 189	2
Lynch v. Turrish, 247 U. S. 221	4

Supreme Court of the United States

October Term, 1927

No. 575

GILBERT C. GREENWAY, JR., *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

REPLY BRIEF FOR PETITIONER.

Statement.

The petitioner has not heretofore submitted a brief upon this appeal but relies upon the brief submitted by him upon the application for certiorari and upon the argument contained in the brief for the petitioner in the case of "Elizabeth C. Taft, Petitioner, v. Frank K. Bowers, Collector", which was heard and decided in the District Court and the Circuit Court of Appeals at the same time as the present case.

The facts in the present case are fully set forth in the brief submitted upon the application for a writ of certiorari.

The petitioner, however, desires to make a brief reply to the contention advanced by the Government in its brief, a copy of which has just been received.

Argument.

The gist of the Government's contention is that a gift constitutes income to the donee; and that the Government could, if it saw fit, tax the entire proceeds of a sale of the gift as income of the donee, from which it follows that it can tax as income of the donee, the difference between the cost of the gift to the donor and the proceeds of the sale of the gift by the donee.

We believe this argument ignores the fundamental fact that income is derivative and complementary. It has no existence independent of the source from which it is derived and is dependent upon capital in some form or upon labor for its very existence.

This conception of the meaning of the word "income" is clearly set forth by Mr. Justice Pitney in the leading case of *Eisner* v. *Macomber*, 252 U. S. 189, in the following language (pp. 207-208):

> "After examining dictionaries in common use (Bouvier's Law Dict.; Standard Dict.; Webster's Int. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of August 5, 1909 (36 Stat. at L. 11, chap. 6), (Stratton's Independence v. Howbert, 231 U. S. 399, 415, 58 L. ed. 285, 292, 34 Sup. Ct. Rep. 136; Doyle v. Mitchell Bros. Co., 247 U. S. 179, 185, 62 L. ed. 1054, 1059, 38 Sup. Ct. Rep. 467): 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle case (pp. 183, 185).
>
> Brief as it is, it indicates the characteristic and distinguishing attribute of income, essential for a

correct solution of the present controversy. The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain', which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived,—*'derived-from-capital'*; —*'the gain-derived-from-capital'*, etc. Here we have the essential matter: *not* a gain *accruing* to capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being *'derived'*, that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal; *that* is income derived from property. Nothing else answers the description.

The same fundamental conception is clearly set forth in the 16th Amendment—'incomes, *from* whatever *source derived'*,— the essential thought being expressed with a conciseness and lucidity entirely in harmony with the form and style of the constitution."

In the Standard Dictionary "income" is defined as follows:

> "The amount of money coming to a person or corporation within a specified time or regularly (when unqualified annually), whether as payment for services, interest, or profit from investment; revenue."

The same Dictionary defines "gift" as follows:

> "That which is given; something voluntarily bestowed without expectation of return; a donation; present."

The same authority gives as synonyms of "gift" the following:

> "Benefaction, boon, bribe, donation, grant, gratuity, present."

And the antonyms are given as follows:

> "Compensation, earnings, guerdon, penalty, remuneration, wages."

Webster, in his New International Dictionary of the English Language, defines "income" as

> "That gain or recurrent benefit (usually measured in money) which proceeds from labor, business or property; commercial revenue or receipts of any kind, including wages or salaries, the proceeds of agriculture or commerce, the rent of houses, or the return on investments."

In Volume 5 of the New English Standard Dictionary (Oxford Edition), "income" is defined as

> "That which comes in as the periodical produce of one's work, business, lands, or investments (considered in reference to its amount, and commonly expressed in terms of money) annual or periodical receipts accruing to a person or corporation; revenue."

If the entire proceeds of the sale of a gift constitute income to the donee, where is the capital from which the income is derived? The answer must be that the corpus of the gift is capital in the hands of the donee at the time of its receipt. But the mere conversion of such capital into money does not constitute income.

Lynch v. *Turrish*, 247 U. S. 221.

An amount sufficient to restore the capital value that existed at the commencement of the taxing period must be withdrawn from the gross proceeds in order to determine whether there has been a gain or loss, and the amount of the gain, if any.

Doyle v. *Mitchell Brothers Company*, 247 U. S. 179.

The popular conception of the meaning of "income" excludes property or money received by way of gift. The ordinary layman would not think of including, as a part of his income, money or property which he had received as a gift.

Petitioner submits that the contention of the Government that "income" and "gift" are synonomous is unsound, and that Section 202 (a) (2) of the Revenue Act of 1921 is unconstitutional in so far as it imposes upon a donee an income tax based upon the difference between the cost of the property to the donor and the value of the property at the time of the gift.

Respectfully submitted,

ROGER S. BALDWIN,
Counsel for Petitioner.

FILE COPY

FILED
OCT 13 1927
CHARLES ELMORE CROPL
CLERK

Nos. 554 and 555

In the Supreme Court of the United States

OCTOBER TERM, 1927

ELIZABETH C. TAFT, PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK

GILBERT C. GREENWAY, JR., PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

U. S. GOVERNMENT PRINTING OFFICE: 1927

INDEX

	Page.
Opinions below	1
Jurisdiction	2
Question presented	2
The statutes	2
Statement	4
Conclusion	7

STATUTES CITED

Revenue Act of 1921, c. 136, 42 Stat. 227, 229, 237:	
Sec. 202(a)(2)	2
Sec. 213	3
Revenue Act of 1924, Sec. 204(a)(2), (3), c. 234, 43 Stat. 253, 258 (U. S. C., Title 26, Sec. 935)	7
Revenue Act of 1926, Sec. 204(a)(2), (3), c. 27, 44 Stat. 9, 14 (U. S. C., App., Title 26, Sec. 935)	7

In the Supreme Court of the United States

OCTOBER TERM, 1927

No. 554

ELIZABETH C. TAFT, PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE for the Second District of New York

No. 575

GILBERT C. GREENWAY, JR., PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE for the Second District of New York

ON PETITIONS FOR WRITS OF CERTIOARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

MEMORANDUM FOR THE RESPONDENT

OPINIONS BELOW

The District Court for the Southern District of New York disposed of both of these cases in one opinion (*Taft case*, R. 13; *Greenway case*, R. 20) which is reported in 15 F. (2d) 890. The Circuit Court of Appeals for the Second Circuit also de-

cided the cases together, each of the three judges, however, writing separate opinions, one dissenting (*Taft case,* R. 27; *Greenway case,* R. 33). These opinions are reported in 20 F. (2d) 561.

JURISDICTION

The judgments sought to be reviewed were entered in each case July 13, 1927. (*Taft case,* R. 44; *Greenway case,* R. 50.) Petition for certiorari was filed in the *Taft case* September 26, 1927, and in the *Greenway case* October 3, 1927. Jurisdiction is conferred upon this Court by Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Both cases present the single question whether or not Section 202(a)(2) of the Revenue Act of 1921, which requires the donee upon the sale of property acquired by gift after December 31, 1920, to use the cost of the property to the donor as the basis for computing profit, is constitutional in so far as it taxes as income to the donee the appreciation in the value of the gift prior to its acquisition by the donee.

THE STATUTES

Section 202(a)(2) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 229, provides:

> That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913,

shall be the cost of such property; except that—

* * * * *

In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner. * * *

Section 213 of the same Act defines "income" as follows (p. 237):

That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any

political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * *

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income).

STATEMENT

In the *Taft case,* petitioner prior to April, 1922, and after December 31, 1920, received as gifts from her father 150 shares of common stock of the Nash Motors Company. (R. 4, 5.) These shares were originally obtained by petitioner's father as a bonus

in connection with the purchase by him of preferred stock of said company, and the amended complaint alleges that the common stock received by him at that time had no market price or value. (R. 6.) As the result of a stock dividend declared in February, 1923, petitioner became the record owner of 750 shares of common and 450 shares of preferred stock in the Nash Motors Company. Some time later, in 1923, petitioner sold 200 shares of common and 130 shares of preferred stock for $34,345.30. (R. 5.) The market value of the original 150 shares of common stock at the time the gifts were made was $42,350. By a method of allocation, as to which there is no dispute, it is found that the shares which were sold in 1923 for $34,345.30 were worth $11,-708.80 when received by petitioner from her father. (R. 6.) In making her return for 1923, petitioner, pursuant to Section 202(a)(2), *supra,* included the entire proceeds of the sale of the stock as income and paid the tax thereon under protest, taking the position that only the difference between the value of the stock when she acquired it and the price at which she sold it was taxable income within the meaning of the Sixteenth Amendment to the Constitution. Accordingly a claim for the refund of $2,040.09, representing the amount of the tax in dispute, was duly filed and after six months this action was brought for recovery. (R. 5, 7–8.)

In the *Greenway case,* petitioner prior to April, 1922, and after December 31, 1920, received as gifts from his brother 10,000 shares of the capital stock

of the Ahumada Lead Company. These shares were originally purchased by petitioner's brother for $10,000. The market value of said shares at the time the gifts were made was $30,000. Subsequently, on or about August 1, 1922, petitioner sold the said 10,000 shares of stock for $52,500. (R. 4–5.) In making his return for 1922, petitioner, pursuant to Section 202(a)(2), *supra,* included as income the sum of $42,500, which represented the difference between the cost of said shares to his brother and the price for which petitioner sold them, and paid the tax thereon under protest, contending that only the difference between the value of the stock when petitioner acquired it and the price at which he sold it was taxable under the Constitution. (R. 6–7.) Upon the rejection by the Commissioner of Internal Revenue of a claim for refund of $4,441.61, representing the amount of the tax in dispute (R. 8), this action was brought for recovery.

The District Court for the Southern District of New York sustained the position of petitioners, holding that no part of the value of a *bona fide* gift as of the date of delivery constitutes taxable income in the hands of the donee within the meaning of the Sixteenth Amendment, and that a tax upon a donee measured by the increase in value from the time the donor originally acquired it until the time the donee sold it was a direct and unconstitutional tax on the gift itself. (*Taft case,* R. 13; *Greenway case,* R. 20.)

Upon writs of error the judgments of the District Court were reversed by the Circuit Court of Appeals for the Second Circuit, each of the three judges rendering separate opinions, one dissenting. (*Taft case,* R. 27–42; *Greenway case,* R. 33–48.) The two prevailing opinions, in upholding the constitutionality of the law, reached that conclusion by somewhat different lines of reasoning.

Provisions similar to Section 202(a)(2) of the 1921 Act here involved are also to be found in Section 204(a)(2) of the Revenue Acts of 1924 and 1926, respectively, c. 234, 43 Stat. 253, 258 (U. S. C., Title 26, Sec. 935); c. 27, 44 Stat. 9, 14 (U. S. C., App., Title 26, Sec. 935). In addition, Section 204(a)(3) of each of those Acts applies the same rule to property acquired after December 31, 1920, "by a transfer in trust."

CONCLUSION

The question presented is one of first impression and of general importance. The same question is involved in a great many other cases now pending in the courts, before the Board of Tax Appeals, and before the Treasury Department. It is desirable that it be settled by this Court, and there is no reason for opposing the issuing of the writ.

WILLIAM D. MITCHELL,
Solicitor General.

MABEL WALKER WILLEBRANDT,
Assistant Attorney General.

SEWALL KEY,
Attorney.

OCTOBER, 1927.

○

FILE COPY

16 & 17

FILED
APR 21 1928
CHARLES ELMORE CROPLEY
CLERK

Nos. ~~554 and 575~~

In the Supreme Court of the United States

OCTOBER TERM, 1927

ELIZABETH C. TAFT, PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK

GILBERT C. GREENWAY, JR., PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

U.S. GOVERNMENT PRINTING OFFICE: 1928

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Constitutional amendment and statutes involved	2
Statement	5
Summary of argument	7
Argument:	
I. The provision of Section 202 (a) (2) which fixes the basis for determining the gain or loss in the case of property acquired by gift is constitutional for the reason that it results in a tax upon income and not upon capital	9
II. The authorities relied upon by petitioner are distinguishable or not inconsistent with the position of respondent	31
Conclusion	34

CITATIONS

Cases:	
Adkins v. *Children's Hospital*, 261 U. S. 525	30
Atlantic Coast Line v. *Daughton*, 262 U. S. 413	25
Brushaber v. *Union Pacific R. R. Co.*, 240 U. S. 1	19
Edwards v. *Cuba Railroad*, 268 U. S. 628	32
Eisner v. *Macomber*, 252 U. S. 189	16–17
Everard's Breweries v. *Day*, 265 U. S. 545	30
Great Northern Railway Co. v. *Lynch*, 292 Fed. 903	18
Hampton, Jr., & Co. v. *United States*, No. 242, October Term, 1927, decided April 9, 1928	30
Heiner v. *Tindle*, No. 341, October Term, 1927, decided April 9, 1928	33
Irwin v. *Gavit*, 268 U. S. 161	11
LaBelle Iron Works v. *United States*, 256 U. S. 377	25
Lynch v. *Hornby*, 247 U. S. 339	18, 19–21
Lynch v. *Turrish*, 247 U. S. 221	29, 32
Merchants' L. & T. Co. v. *Smietanka*, 255 U. S. 509	10
Nicol v. *Ames*, 173 U. S. 509	30
Peabody v. *Eisner*, 247 U. S. 347	18, 21
Pollock v. *Farmers' Loan & Trust Co.*, 157 U. S. 429	13
Purity Extract Co. v. *Lynch*, 226 U. S. 192	29
Rice v. *Eisner*, 16 F. (2d) 358	12
Ruppert v. *Caffey*, 251 U. S. 264	30
Shaffer v. *Carter*, 252 U. S. 37	18

Cases—Continued. Page

United States v. *Berwind-White Coal Mining Co.*, 274 U. S. 564 ---- 30

United States v. *Oregon-Washington R. & Nav. Co.*, 251 Fed. 211 ---- 12, 31

United States v. *Phellis*, 257 U. S. 156 ---- 18, 22–24

Statutes:

Act of August 27, 1894, c. 349, Section 28, 28 Stat. 509 ---- 13

32 Del. L. 20 (1921), Section 3 (a) ---- 14

Income Tax Act of 1842, c. 35, 5 and 6 Vict., Section 102 ---- 13

Missouri Revised Statutes (1919), c. 119, Art. 19, Section 13109 ---- 14

Revenue Act of 1913, c. 16, Section IIB, 38 Stat. 114 ---- 12

Revenue Act of 1916, c. 463, Section 4, 39 Stat. 756 ---- 12, 13

Revenue Act of 1917, c. 63, Section 1200, 40 Stat. 300 ---- 12

Revenue Act of 1918, c. 18, Section 213 (b) (3), 40 Stat. 1057 ---- 12

Revenue Act of 1921, c. 136, 42 Stat. 227—

Section 202 (a) (2) ---- 3

Section 213 ---- 3, 12

Revenue Act of 1924, c. 234, 43 Stat. 253—

Section 204 (a) (2), (3) (U. S. C., Title 26, Sec. 935) ---- 7

Section 213 (b) (3) (*Ibid.*, Sec. 654) ---- 12

Revenue Act of 1926, c. 27, 44 Stat. 9—

Section 204 (a) (2), (3), (U. S. C. App., Title 26, Sec. 935) ---- 7

Section 213 (b) (3), (*Ibid*, Sec. 954) ---- 12

Virginia Acts of Assembly (1922), c. 463, Section 10 (3) (h) ---- 14

Wisconsin Statutes (1925), Vol. I, Title 10, c. 71, Section 71.05 (1) (g) ---- 14

Miscellaneous:

Constitution of the United States, Sixteenth Amendment ---- 2

House Report No. 350, 67th Congress, 1st Session, p. 9 ---- 28

Senate Report No. 275, 67th Congress, 1st Session, p. 10 ---- 27

In the Supreme Court of the United States

OCTOBER TERM, 1927

No. 554

ELIZABETH C. TAFT, PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE for the Second District of New York

---

No. 575

GILBERT C. GREENWAY, JR., PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE for the Second District of New York

---

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The District Court for the Southern District of New York disposed of both of these cases in one opinion (*Taft case*, R. 8; *Greenway case*, R. 12–13), which is reported in 15 F. (2d) 890. The Circuit Court of Appeals for the Second Circuit also de-

cided the cases together, each of the three judges, however, writing a separate opinion, one dissenting. (*Taft case,* R. 14–23; *Greenway case,* R. 19–28.) These opinions are reported in 20 F. (2d) 561.

JURISDICTION

The judgments sought to be reviewed were entered in each case July 13, 1927. (*Taft case,* R. 24; *Greenway case,* R. 28.) Petition for certiorari was filed in the *Taft case* September 26, 1927, and in the *Greenway case* October 3, 1927, and were granted pursuant to Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Both cases present the single question whether or not Section 202 (a) (2) of the Revenue Act of 1921, which requires the donee upon the sale of property acquired by gift after December 31, 1920, to use the cost of the property to the donor as the basis for computing profit, is constitutional in so far as it taxes as income to the donee the appreciation in the value of the gift prior to its acquisition by the donee.

CONSTITUTIONAL AMENDMENT AND STATUTES INVOLVED

The Sixteenth Amendment to the Constitution of the United States provides:

> The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Section 202 (a) (2) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 229, provides:

> SEC. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—
>
> * * * * *
>
> (2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner. * * *.

Section 213 of the same Act defines "income" as follows (p. 237):

> SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensa-

tion for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * *

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income); * * *.

STATEMENT

In the *Taft case* petitioner, prior to April, 1922, and after December 31, 1920, received as gifts from her father 150 shares of common stock of the Nash Motors Company. (R. 3.) These shares were originally obtained by petitioner's father as a bonus in connection with the purchase by him of preferred stock of said company, and the amended complaint alleges that the common stock received by him at that time had no market price or value. (R. 4.) As the result of a stock dividend declared in February, 1923, petitioner became the record owner of 750 shares of common and 450 shares of preferred stock in the Nash Motors Company. (R. 3.) Some time later, in 1923, petitioner sold 200 shares of common and 130 shares of preferred stock for $34,345.30. (R. 3–4.) The market value of the original 150 shares of common stock at the time the gifts were made was $42,350. By a method of allocation, as to which there is no dispute, it is found that the shares which were sold in 1923 for $34,345.30 were worth $11,708.80 when received by petitioner from her father. (R. 4.) In making her return for 1923, petitioner, pursuant to Section 202 (a) (2), *supra,* included the entire proceeds of the sale of the stock as income and paid the tax thereon under protest. (R. 4.) A claim for the refund of $2,040.09, representing the amount of the tax in dispute, was duly filed and after six months this action was brought for recovery (R. 5), upon the ground that only the

difference between the value of the stock when she acquired it and the price at which she sold it was taxable income within the meaning of the Sixteenth Amendment to the Constitution.

In the *Greenway case* petitioner received as gifts from his brother 10,000 shares of the capital stock of the Ahumada Lead Company, 5,000 shares on or about March 29, 1921, and 5,000 additional shares on or about March 1, 1922. These shares were originally purchased by petitioner's brother for $10,000. The market value of said shares at the time the gifts were made was $30,000. Subsequently, on or about August 1, 1922, petitioner sold the said 10,000 shares of stock for $52,500. (R. 3.) In making his return for 1922, petitioner, pursuant to Section 202 (a) (2), *supra,* included as income the sum of $42,500, which represented the difference between the cost of said shares to his brother and the price for which petitioner sold them, and paid the tax thereon under protest. (R. 4.) Upon the rejection by the Commissioner of Internal Revenue of a claim for refund of $4,441.61, representing the amount of the tax in dispute (R. 6), this action was brought for recovery, petitioner contending that only the difference between the value of the stock when petitioner acquired it and the price at which he sold it was taxable under the Constitution. (R. 5.)

The District Court for the Southern District of New York sustained the position of petitioners,

holding that no part of the value of a *bona fide* gift as of the date of delivery constitutes taxable income in the hands of the donee within the meaning of the Sixteenth Amendment, and that a tax upon a donee measured by the increase in value from the time the donor originally acquired it until the time the donee sold it was a direct and unconstitutional tax on the gift itself. (*Taft case,* R. 8; *Greenway case,* R. 12.)

Upon writs of error the judgments of the District Court were reversed by the Circuit Court of Appeals for the Second Circuit, each of the three judges rendering a separate opinion, one dissenting. (*Taft case,* R. 14–23; *Greenway case,* R. 19–28.)

Provisions similar to Section 202 (a) (2) of the 1921 Act here involved are also to be found in Section 204 (a) (2) of the Revenue Acts of 1924 and 1926, respectively, c. 234, 43 Stat. 253, 258 (U. S. C., Title 26, Sec. 935); c. 27, 44 Stat. 9, 14 (U. S. C. App., Title 26, Sec. 935). In addition, Section 204 (a) (3) of each of those Acts applies the same rule to property acquired after December 31, 1920, "by a transfer in trust."

SUMMARY OF ARGUMENT

Section 213 (b) (3) of the Revenue Act of 1921 provides that the income from property acquired by gift shall be included in gross income, and Section 202 (a) (2) provides the measure of the income from the sale of a gift. Petitioners contend that in

so far as the statute attempts to tax that part of the proceeds of the sale of a gift which represents its accumulated increase in value in the hands of the donor before acquisition by the donee, it is unconstitutional for the reason that that part represents capital to the donee at the time of acquisition by him.

The contention is based upon the premise that a gift is inherently capital. However, a gift is a transfer of property and results in clear gain to the donee. In the ordinary sense of the word and as it is used in common speech "gift" conveys the idea of income. Congress would have had no need to exempt specifically the value of a gift from gross income unless it actually was income.

If a gift is income, then it follows that Congress has power to tax the whole value or any portion of it. In the statute here involved Congress has clearly manifested its intention of taxing part of the value of a gift as income, and it is submitted that this is clearly within its power. The mere fact that Congress has imposed the tax at the time when the sale of the gift occurs should not render the tax any the less valid.

In imposing this tax it was the intention of Congress that the donee should stand in the shoes of the donor and take the gift charged with the tax which would ultimately accrue upon the gain then accumulated when later realized.

This tax may also be sustained upon the theory that it is a tax upon the income from property as distinguished from the income of the owner.

ARGUMENT

I

THE PROVISION OF SECTION 202 (A) (2) WHICH FIXES THE BASIS FOR DETERMINING THE GAIN OR LOSS IN THE CASE OF PROPERTY ACQUIRED BY GIFT IS CONSTITUTIONAL FOR THE REASON THAT IT RESULTS IN A TAX UPON INCOME AND NOT UPON CAPITAL

Although Section 213 (b) of the Revenue Act of 1921 exempts in general terms the value of property acquired by gift, Section 202 (a) (2) specifically requires the recipient of a gift in case of a sale to pay a tax upon the proceeds, such tax to be measured by the difference between the cost to the donor and the price for which sold by the donee. It is plain that there is no conflict between those two provisions. On the contrary, they are coordinated and in complete harmony. Section 213 (b) (3) provides that the income from a gift shall be taxable and Section 202 (a) (2) provides the measure for that tax in the case of the sale of the gift.

Petitioners concede that that part of the proceeds of the sale of a gift which represents the increase in the hands of the donee after acquisition is properly taxable. They contend, however, that the provision of Section 202 (a) (2) is unconstitutional in so far as it attempts to tax that part of the proceeds

of the sale of the gift which represents its accumulated increase in value in the hands of the donor before acquisition by the donee, for the reason that that part represents capital to the donee at the time of acquisition by him.

That contention is based upon the premise that a gift is in its intrinsic nature capital, but petitioners fail to establish that premise. While the question whether or not a gift is inherently capital or income has never been directly decided, the clear inference to be drawn from the manner in which gifts have been treated in various income tax laws, both Federal and State, is that they are to be regarded as inherently income. The commonly accepted meaning of the word "income" leads to the same conclusion.

In considering the meaning to be given the word "income" as used in the Sixteenth Amendment and in the Revenue Acts pursuant thereto, the courts have consistently construed the word in its ordinary sense and as it is used in common speech. Thus in *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509, in construing the meaning of the word "income" as used in the Revenue Act of 1916, this Court said (p. 519):

> In determining the definition of the word "income" thus arrived at, this court has consistently refused to enter into the refinements of lexicographers or economists and has approved, in the definitions quoted, what

it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution.

It would seem that in the ordinary sense of the word and as it is used in common speech, the word "gift" conveys the meaning of true income to the donee. A gift is a transfer of property and results in clear gain to the donee; there is manifestly a receipt of gain. It would certainly surprise the man in the street, for whom the tax laws are intended, to be told that if he received a gift under the circumstances of these cases he would not have made a gain nor be in receipt of income. If this gain is not income "from whatever source derived"—the language both of the Sixteenth Amendment and the Revenue Acts—then, as stated in *Irwin* v. *Gavit,* 268 U. S. 161, 166, the Revenue Act of 1921 has "missed so much of the general purpose that it expresses at the start."

We have been unable to find any judicial decision or any expression by a text writer, or any method of treatment in a taxing statute which indicates that, by reason of its intrinsic nature, a gift can not be income.

It is also a fair presumption that Congress considered a gift to be in its nature income, by reason of the fact that it deemed it necessary to specifically exempt gifts in all the Income Tax Acts from

1913 to 1926, inclusive.[1] Manifestly, if Congress had considered a gift to be in its nature capital there would have been no need for its specific exemption. It is apparent that the exemption was thought to be necessary because in its absence a gift would naturally be included in the general definition of gross income. Circuit Judge Learned Hand came to this same conclusion in announcing the decision of the Circuit Court of Appeals for the Second Circuit in the case of *Rice* v. *Eisner,* 16 F. (2d) 358, certiorari denied 273 U. S. 764, where he said (p. 360):

> The exemption in all the statutes of the corpus of gifts and bequests shows that in the minds of those who drew the acts it was thought open to question whether even this might not be considered income.

To the same effect is the dissenting opinion of Circuit Judge Ward filed in *United States* v. *Oregon-Washington R. & Nav. Co.,* 251 Fed. 211, 214:

> The Income Tax Laws of 1913, 1916, and 1917 expressly provide that only the income of gifts is to be taxed, from which it may be inferred, that but for this provision, the gifts themselves would have been taxed as income.

---

[1] Revenue Act of 1913, c. 16, Sec. IIB, 38 Stat. 114, 167; Revenue Act of 1916, c. 463, Sec. 4, 39 Stat. 756, 758; Revenue Act of 1917, c. 63, Sec. 1200, 40 Stat. 300, 329; Revenue Act of 1918, c. 18, Sec. 213 (b) (3), 40 Stat. 1057, 1065; Revenue Act of 1921, c. 136, Sec. 213 (b) (3), 42 Stat. 227, 238; Revenue Act of 1924, c. 234, Sec. 213 (b) (3), 43 Stat. 253, 268; Revenue Act of 1926, c. 27, Sec. 213 (b) (3), 44 Stat. 9, 24.

But the inference is even stronger than stated in the above cases. Congress in exempting the value of gifts from gross income in the Revenue Act of 1916 specifically referred to it as income. Section 4 of that Act reads:

> SEC. 4. The following *income* shall be exempt from the provisions of this title:
> * * * the value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included as income); * * *. (Italics ours.)

Section 4 of the Revenue Act of 1916 was amended by Section 1200 of the Revenue Act of 1917, but the language of that portion now under consideration was not changed by the amendment.

It should also be noted that Section 28 of the Act of 1894, c. 349, 28 Stat. 509, specifically included as taxable income "money and the value of all personal property acquired by gift or inheritance."

The inclusion of gifts in income under that Act was not one of the grounds upon which the Act was held unconstitutional in the case of *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, affirmed on rehearing, 158 U. S. 601.

The English law, after which it is generally known the American tax laws, both State and Federal, were in substance modeled, in the Income Tax Act of 1842 (c. 35, 5 and 6 Vict.), Section 102, levies a tax "upon all *Annuities*, yearly Interest of Money, or other annual Payments." (Italics ours.)

It is also true that the States, while they exempt gifts from taxable income, accomplish it in such a manner as to make it evident that the legislatures considered gifts to be income in fact. For example, Delaware, Missouri, Wisconsin, and Virginia specifically denominate the exemption as one of income.[2]

In Section 10 of the Act of the Virginia Assembly of 1922, c. 463, there is exempted from taxable income "The value of property acquired by gift within the year not exceeding the sum of one thousand dollars." Under this Act, therefore, the value of property acquired by gift is clearly recognized as income, although only a portion is taxable.

From the foregoing it is submitted that gifts are income in fact and that when they are exempted it is not because of anything inherent in their nature which precludes their classification as income. A gift under the circumstances of these cases is inherently a gain or profit to the donee. The fact that a gift is a part of the donor's capital does not mean that it has an unalterable capital nature and must be and remain capital to the donee.

If we are correct in our position that a gift is income in the ordinary sense of the word, then it of course follows that Congress has the power to tax either the whole value or any portion of that

[2] 32 Del. L. 20 (1921), Section 3 (a); Revised Statutes, Mo. (1919), c. 119, Art. 19, Section 13109; Wisconsin Statutes (1925), Vol. 1, Title 10, c. 71, Section 71.05 (1) (g); Va. Acts of Assembly (1922), c. 463, Section 10 (3) (h).

value as income. While Congress has apparently not deemed it expedient to tax the whole of a gift as income, as shown by the exemption, it has, on the other hand, clearly manifested its intention of taxing part of a gift as income where there has been a gain in the property transferred under the circumstances of these cases.

Because Congress has not taxed the whole gift when it was clearly all income to the donee, petitioners contend that the taxation thereafter of any greater amount than it has subsequently increased in value is unconstitutional. If it once becomes a part of the donee's property it is contended that it is his capital. It is admitted that the subsequent increase in its value after it comes into the donee's hands, is properly taxable, and yet that increase is also capital until it is released by sale. If the act of sale, to that extent, converts the increase of the gift into income when realized, why can not the same act of sale reconvert the value of a gift at the time it was received into income? If the act of sale of purchased property separates the increase from capital, and the income is the difference between the investment and the selling price, it would seem to follow logically, as a practical matter, and having due regard for the substance, that the income from the sale of a gift is the difference between the investment of the donee and the selling price. The property having cost the donee nothing, it would not be arbitrary or capricious to im-

99675—28——3

pose a tax upon the whole selling price. If Congress has the power to tax the whole selling price as income, there is surely nothing arbitrary in the imposition of a tax upon a portion only of that income. The difference between the price received by the donee and the original cost to the donor is none the less all income, even though it does not represent the entire gain or profit received by the donee at the time of sale.

Nor is this characterization of a gift as income inconsistent with the definition of income which this Court pronounced in *Eisner* v. *Macomber,* 252 U. S. 189. In that case the Court was interpreting the meaning of income as provided in the Revenue Act of 1916. That Act, as previously shown, specifically exempted the value of a gift from gross income. Consequently the definition of income in *Eisner* v. *Macomber* reflects that exemption.

In the *Eisner case* this Court was primarily concerned with the determination of whether or not there had been a separation of income from capital. In these cases, however, the Court is not called upon to determine whether there has been a severance of income from capital, but the sole question is whether or not the classification by Congress of a part of the value of a gift as income to the donee is beyond its power. In other words, the Court is here called upon solely to distinguish between what is and what is not in fact income in common speech and in the ordinary sense of the word. If the definition

is to be judged by those standards—and this Court in the cases cited above has held that the meaning of that word is to be so determined—there can be little doubt as to the constitutionality of the provision here under consideration.

Furthermore, it is clear that in the case of *Eisner* v. *Macomber* the Court was not necessarily prescribing the uttermost limits of the definition of the word "income." As there said with reference to the said definition (p. 207):

> Brief as it is, it indicates the characteristic and distinguishing attribute of income *essential for a correct solution of the present controversy.* (Italics ours.)

And again (p. 206):

> * * * it becomes essential to distinguish between what is and what is not "income," as the term is there used; and to apply the distinction, *as cases arise,* according to truth and substance, without regard to form. (Italics ours.)

From this it is plain that this Court recognized that *Eisner* v. *Macomber* did not establish an immutable definition but that occasion might arise in the future where it would be called upon to amplify this definition.

In this connection it should also be borne in mind that the constitutionality of a tax depends upon its practical operation and effect, and not on mere definition or theoretical distinction respecting its

nature and quality. *Shaffer* v. *Carter,* 252 U. S. 37. In that case this Court said (p. 51):

> Income taxes are a recognized method of distributing the burdens of government, favored because requiring contributions from those who realize current pecuniary benefits under the protection of the government, and because the tax may be readily proportioned to their ability to pay.

The broad scope to be given to the term "income" was also considered by this Court in *Lynch* v. *Hornby,* 247 U. S. 339, 343–344, where this Court said:

> * * * Congress was at liberty under the Amendment to tax as income, without apportionment, everything that became income, in the ordinary sense of the word, after the adoption of the Amendment * * *.

While there is no case directly in point on the question here involved, the respondent believes that the correct principles for the solution of the problem are to be found in *Lynch* v. *Hornby,* 247 U. S. 339; *Peabody* v. *Eisner,* 247 U. S. 347; *United States* v. *Phellis,* 257 U. S. 156, and *Great Northern Railway Co.* v. *Lynch,* 292 Fed. 903.

The fair market value of property on March 1, 1913, is usually recognized as capital. However, in *Lynch* v. *Hornby, supra,* when the accumulated earnings of a corporation before that date were realized thereafter as dividends to stockholders,

this Court found no difficulty in holding that such dividends constituted income to the stockholders. In that case it was said (pp. 343–344, 346):

> Corporate profits that accumulated before the act took effect stand on a different footing. As to these, however, just as we deem the legislative intent manifest to tax the stockholder with respect to such accumulations only if and when, and to the extent that, his interest in them comes to fruition as income, that is, in dividends declared, so we can perceive no constitutional obstacle that stands in the way of carrying out this intent when dividends are declared out of a preexisting surplus. The act took effect on March 1, 1913, a few days after the requisite number of States had given approval to the Sixteenth Amendment, under which for the first time Congress was empowered to tax income from property without apportioning the tax among the States according to population. *Southern Pacific Co.* v. *Lowe, supra.* That the retroactivity of the act from the date of its passage (October 3, 1913) to a date not prior to the adoption of the Amendment was permissible is settled by *Brushaber* v. *Union Pacific R. R. Co.,* 240 U. S. 1, 20. And we deem it equally clear that Congress was at liberty under the Amendment to tax as income, without apportionment, everything that became income, in the ordinary sense of the word, after the adoption of the Amendment, including dividends re-

ceived in the ordinary course by a stockholder from a corporation, even though they were extraordinary in amount and might appear upon analysis to be a mere realization in possession of an inchoate and contingent interest that the stockholder had in a surplus of corporate assets previously existing. Dividends are the appropriate fruit of stock ownership, are commonly reckoned as income, and are expended as such by the stockholder without regard to whether they are declared from the most recent earnings, or from a surplus accumulated from the earnings of the past, or are based upon the increased value of the property of the corporation. The stockholder is, in the ordinary case, a different entity from the corporation, and Congress was at liberty to treat the dividends as coming to him *ab extra*, and as constituting a part of his income when they came to hand.

Hence we construe the provision of the act that "the net income of a taxable person shall include gains, profits, and income derived from * * * interest, rent, dividends, * * * or gains or profits and income derived from any source whatever" as including (for the purposes of the additional tax) all dividends declared and paid in the ordinary course of business by a corporation to its stockholders after the taking effect of the act (March 1, 1913), whether from current earnings, or from the accumulated surplus made up of past earnings or increase in value of corporate assets, not-

withstanding it accrued to the corporation in whole or in part prior to March 1, 1913.

* * * * *

We repeat that under the 1913 Act dividends declared and paid in the ordinary course by a corporation to its stockholders after March 1, 1913, whether from current earnings or from a surplus accumulated prior to that date, were taxable as income to the stockholder.

We do not overlook the fact that every dividend distribution diminishes by just so much the assets of the corporation, and in a theoretical sense reduces the intrinsic value of the stock. But, at the same time, it demonstrates the capacity of the corporation to pay dividends, holds out a promise of further dividends in the future, and quite probably increases the market value of the shares. In our opinion, Congress laid hold of dividends paid in the ordinary course as *de facto* income of the stockholder, without regard to the ultimate effect upon the corporation resulting from their payment.

In *Peabody* v. *Eisner,* 247 U. S. 347, this Court again disregarded the March 1, 1913, value of the stock involved in that case and held the dividend received thereafter was wholly taxable, irrespective of the fact that on March 1, 1913, the capital value of the stock represented a portion of the gain which was subsequently realized as dividends.

But petitioners contend that even if a gift is income, it is only income in the year of its acquisition by the donee and that, therefore, it can not be taxed

as income of a later year. This contention, of course, is not involved with respect to the shares constituting the gift of 1922 in the *Greenway case,* for the reason that they were sold in the same year as received. To that extent, at least, if the respondent's argument as to the inherent nature of a gift is correct, there can be no question of the validity of the tax.

The respondent contends, however, that the mere fact that Congress has in its scheme of taxation fixed a later period in which to tax a gift, that is, the year in which the gain on the property involved in a gift is actually realized through conversion, does not present any difficulty or render the tax any the less valid. This is clear from the *Great Northern case, supra.* In that case, arising under the Corporation Tax Act of 1909, certain unpaid obligations of a corporation accruing prior to the year 1909, were written off the books in 1911 because outlawed by the statute of limitations. The court there held that the amount of these obligations constituted income *in the year in which written off.*

United States v. *Phellis,* 257 U. S. 156, is a clear example of the fact that accumulated gains are taxable as income when realized, despite the fact that they may appear to constitute a portion of capital. Phellis was the holder of stock in a New Jersey corporation which effected a plan of reorganization, pursuant to which a new corporation was formed in Delaware. All the assets of the New Jersey com-

pany were transferred to the Delaware company as a going concern, including the good will and a large surplus, and in part consideration the New Jersey corporation received the Delaware company's debenture stock and common stock. The latter was immediately distributed to the New Jersey company's common stockholders as a dividend. This Court held that the shares he received in the Delaware company constituted a dividend to Phellis. The opinion written by Mr. Justice Pitney contains the following pertinent language (pp. 169, 171–172):

> Claimant's capital investment was represented by his New Jersey shares. Whatever increment of value had accrued to them prior to September 30, 1915, by reason of the surplus profits that theretofore had been accumulated by the company, was still a part of claimant's capital, from which as yet he had derived no actual and therefore no taxable income so far as the surplus remained undistributed.
>
> * * * * *
>
> The possibility of occasional instances of apparent hardship in the incidence of the tax may be conceded. Where, as in this case, the dividend constitutes a distribution of profits accumulated during an extended period and bears a large proportion to the par value of the stock, if an investor happened to buy stock shortly before the dividend, paying a price enhanced by an estimate of the capital plus the surplus of the company, and after

distribution of the surplus, with corresponding reduction in the intrinsic and market value of the shares, he were called upon to pay a tax upon the dividend received, it might look in his case like a tax upon his capital. But it is only apparently so. In buying at a price that reflected the accumulated profits, he of course acquired as a part of the valuable rights purchased the prospect of a dividend from the accumulations—bought "dividend on," as the phrase goes—and necessarily took subject to the burden of the income tax proper to be assessed against him by reason of the dividend if and when made. He simply stepped into the shoes, in this as in other respects, of the stockholder whose shares he acquired, and presumably the prospect of a dividend influenced the price paid, and was discounted by the prospect of an income tax to be paid thereon. In short, the question whether a dividend made out of company profits constitutes income of the stockholder is not affected by antecedent transfers of the stock from hand to hand.

So in the statute here involved Congress has provided that the donee shall step into the shoes of the donor and shall receive the gift charged with the tax which would become due at that time if the property were sold and the gain realized. Congress permitted the gift to go untaxed at the time of its receipt but charged the donee with the accumulated profit, as yet unrealized; hence the donee took the

gift with notice that when that accumulated profit was thereafter realized it would be taxable income.

In this connection it is also pertinent to call attention to the fact that in *Atlantic Coast Line* v. *Daughton,* 262 U. S. 413, this Court held that a state could, consistently with the Federal Constitution, impose a tax upon the net income of property as distinguished from the net income of him who owns or operates it. While that case involves a State law, it is apparent that the principle would be no different in a case involving a Federal law.

The opinion below, of Circuit Judge Learned Hand, reflects the same thought. He says (*Taft case,* R. 21; *Greenway case,* R. 26):

> I am not concerned for the moment with whose gain it is, but that the whole gain is income can not, I submit, be disputed. If it is important, I suggest that the language of the Amendment itself gives Congress power to lay "taxes on incomes," not on persons. Therefore there is a subject-matter which Congress may tax without apportionment, and part of which, after *Eisner* v. *Macomber,* it could not tax in any other way, except perhaps as an excise.

As this Court said in *LaBelle Iron Works* v. *United States,* 256 U. S. 377, 392:

> The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the States under the equal-protection clause, much less of Con-

gress under the more general requirement of due process of law in taxation. Of course it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion, within the bounds of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation.

This position of the respondent finds support in the opinion of Judge Manton in the court below (*Taft case*, R. 17; *Greenway case*, R. 22):

> The obvious purpose of section 202 (a) (2) was to prevent the loss of income represented within the profit to the donor during the period he held the property before he made his gift. Congress has determined that this same increment shall be recognized as income, even though a gift intervenes. The transfer by gift is but a change of ownership in the specific property. In doing this, Congress imposes no tax upon an unrealized gain. The value of the property is ignored or not taken into account until the property is finally disposed of in such a way that it could be determined that the owner made either a gain or a loss, and, until there is a sale, there is no necessity for measuring income, nor is there an opportunity to do so. This avoids tax evasion or tax avoidance. This statute puts the donee, who pays nothing for the property, and who therefore loses nothing, on

any theory of economic principle, in the position the donor would have been, in so far as taxation is concerned.

The need for the statute is disclosed by the report of the Senate Committee on Finance upon the Revenue bill of 1921 (Report No. 275, 67th Congress, 1st Session, pp. 10–11):

> An essential change, however, is made in the case of property acquired by gift. No explicit rule is found in the present statute for determining gain or loss resulting from the sale of such property, but the Treasury Department has held that the proper basis for such determination is the fair market price or value of such property at the time of its acquisition by the donee. This rule has been the source of serious abuse. Taxpayers who have property the value of which has increased, give such property to wives or relatives, by whom it may be sold without taxation of the increase in value which took place while the property was owned by the donor. The proposed bill, in paragraph (2) of subdivision (a), provides a new and just rule, namely, that in the case of property acquired by gift after December 31, 1920, the basis for computing gain or loss is the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. This means that if the property cost the donor $50, and at the time it was given to the donee it was worth $100, for which

> amount it is sold by the donee, the income of the donee would be $50 instead of nothing, as under the present law. If the facts necessary to determine the cost are unknown to the donee, the commissioner is empowered to obtain the facts from the donor or any other person, or, if it is found impossible to obtain such facts, to appraise the value of such property as of the time it was acquired by such donor or last preceding owner. This paragraph does not apply to gifts made in contemplation of death or to gifts made to take effect in possession and enjoyment at or after death, but such testimentary gifts are to be treated as bequests or devises.

The report of the Ways and Means Committee of the House of Representatives contains a similar statement. (Report No. 350, 67th Congress, 1st Session, p. 9.)

It is submitted that the above discussion and authorities lead to the conclusion that gifts are income in the ordinary sense of the word. That Congress and the State legislatures so regard them is apparent from the treatment accorded them in the Revenue Acts, certain Acts taxing them as income, and others, while recognizing gifts as income, nevertheless exempting them from taxable income. If they are income, it results that Congress is at liberty under the Sixteenth Amendment to levy a tax without apportionment upon their value and by the same authority to tax a portion only of their value and at the same time postpone the tax until the

time of sale. So far as the 1922 gift in the *Greenway case* is concerned, since it was sold in the same year it was received it would seem to require no extended discussion to sustain the validity of the tax as applied to it.

Not only does a gift seem to meet the concept of income but, on the other hand, it does not seem to meet the concept of capital in so far as capital has been defined. The commonly advanced theory depicts capital as a reservoir supplied from springs. *Eisner* v. *Macomber, supra,* p. 206. And the definition has been presented that capital is anything, material or otherwise, capable of ownership, viewed in its static condition at a moment of time, or the rights of ownership therein. *Lynch* v. *Turrish,* 247 U. S. 221, 227.

It is plain that the gift during the act of transfer to the donee is not in a static condition. It is then in flux and can not be capital until it comes to rest in the reservoir of the donee.

It is accordingly submitted that the statute is constitutional. However, in view of the contrary contention which is being pressed upon the Court, respondent calls attention to two cardinal principles of construction which are applicable to this case.

This Court has often recognized that a measure may be valid as a necessary adjunct to a matter that lies within legislative power, even though, standing alone, its constitutionality might have been subject to doubt. *Purity Extract Co.* v. *Lynch,*

226 U. S. 192; *Ruppert* v. *Caffey,* 251 U. S. 264, 289; *Everard's Breweries* v. *Day,* 265 U. S. 545, 560.

If this statute falls, the definition of income as laid down by this Court will lose one of its important concepts, namely, that the definition must be held to "include profit gained through a sale or conversion of capital assets." If increment upon the sale of a capital asset is income and the same increment is not income when a gift intervenes, the number of cases of intervention will be many. Therefore, in support of this statute respondent relies upon the broad ground that it is a necessary part of an entire taxing scheme which is deemed necessary to satisfy the need of the Government for revenue.

Respondent further relies upon the presumption, repeatedly indulged, in favor of the validity of an Act of Congress. *Nicol* v. *Ames,* 173 U. S. 509; *United States* v. *Berwind-White Coal Mining Co.,* 274 U. S. 564; *Hampton, Jr., & Co.* v. *United States,* No. 242, October Term, 1927, decided April 9, 1928. And the presumption should be particularly strong where the objection to an Act arises, not from a specific limitation or prohibition on congressional power, but only out of the "vague contours of the Fifth Amendment, prohibiting the depriving any person of liberty or property without due process of law." *Adkins* v. *Children's Hospital,* 261 U. S. 525, 568.

II

THE AUTHORITIES RELIED UPON BY PETITIONER ARE DISTINGUISHABLE OR NOT INCONSISTENT WITH THE POSITION OF RESPONDENT

Petitioner strongly relies upon the decision of the Circuit Court of Appeals for the Second Circuit in the case of *United States* v. *Oregon-Washington R. & Nav. Co.*, 251 Fed. 211. The Oregon Short Line Company owned all the stock of the Oregon-Washington Railway & Navigation Company, to which the former had also advanced a considerable sum of money. In a rearrangement of these book items the Short Line Company released its debt against the Oregon-Washington Railway & Navigation Company to the approximate amount of six million dollars. This release the Government treated as part of the income of the Oregon-Washington Railway & Navigation Company for that year. The court held that the transaction did not result in income for the reason that since the Short Line Company owned all the stock of the Oregon-Washington Railway & Navigation Company and also the debt, the release of the debt was a means of contribution to the capital of the Oregon-Washington Railway & Navigation Company quite as though the money had been contributed by the stockholder to enhance the value of his stock.

It is clear, however, that a cancellation of indebtedness is not always a contribution to capital, as is shown by the instance cited in the *Oregon-Washington case* of a cancellation of bond coupons. The decision in the *Great Northern case, supra,* is another instance. Therefore, the *Oregon-Washington case* is no authority for the contention that a cancellation of indebtedness is inherently a contribution to capital.

Nor does *Edwards* v. *Cuba Railroad,* 268 U. S. 628, support petitioners' contention that the value of a gift is capital. The opinion in that case did not rest upon that premise. In fact, this Court did not even regard the subsidies there involved as true gifts. With respect to that point this Court said (p. 632):

> Such aids, gifts and grants from the government, subordinate political subdivisions or private sources,—whether of land, other property, credit or money,—in order to induce construction and operation of railroads for the service of the public are not given as mere gratuities.

While this case is authority for the contention that a subsidy is a contribution to capital, the decision distinguishes subsidies from gifts and is no authority for the proposition that a gift is inherently capital.

The decision in *Lynch* v. *Turrish,* 247 U. S. 221, rested upon the finding that there was a mere change in the form of property, without any in-

crease in value. Therefore that case is not helpful in determining the proper method of measuring gains.

Neither can petitioners find any support for their contention in the recent decision of this Court in the case of *Heiner* v. *Tindle,* No. 341, October Term, 1927, decided April 9, 1928. The question here involved was not an issue in that case and no argument with regard to the nature of a gift or the basis adopted in the Revenue Act of 1921 for measuring gain upon the sale of a gift was presented to the Court. The discussion in the opinion regarding gifts was merely by way of illustration and was not the ground of the decision. Furthermore, the Court was considering the Revenue Act of 1918, and quite evidently had in mind the provisions of that Act and the regulations issued thereunder. There is nothing in the language of that opinion which in any manner touches the new basis adopted in the Revenue Act of 1921 for measuring the gain or loss upon the sale of a gift.

Petitioners' brief is predicated upon the theory that a gift is capital to the donee, but the cases cited do not support that contention. They are simply to the effect that the capital investment must first be deducted from the gross proceeds of sale before there can be a determination of gain. The respondent's position is not in conflict with those cases for the reason that, as pointed out above, the capital investment of a donee in the case of a gift is zero.

CONCLUSION

A gift is clear gain to the donee and its value is true income. It is apparent that since Congress has exempted the value of gifts from taxable income the Government is put to the narrow choice of taxing the donee for the gain or nobody at all. It is evident that the method adopted results in reaching only what is clearly a gain accruing to property which was the subject of the gift, and it is submitted that under such circumstances an arbitrary or capricious character can not be ascribed to the tax. Having exempted the value of the gift from taxation when received, it is difficult to give assent to a contention which requires the finding that the tax imposed upon a lesser portion of that value when realized is so wholly arbitrary as to amount to confiscation.

It is respectfully submitted that the judgments below should be affirmed.

WILLIAM D. MITCHELL,
Solicitor General.

MABEL WALKER WILLEBRANDT,
Assistant Attorney General.

SEWALL KEY,
Attorney.

J. LOUIS MONARCH,
Attorney.

APRIL, 1928.

○

FILE COPY

FILED
OCT 8 1928
CHARLES ELMORE CROPLEY
CLERK

Nos. 16 and 17

In the Supreme Court of the United States

OCTOBER TERM, 1928

ELIZABETH C. PEET, PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK

GILBERT C. GRISWOLD, JR., PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL BRIEF FOR THE RESPONDENT ON RECONSIDERATION

(4)

INDEX

	Page
Statement	1
Summary of argument	2
Argument:	
I. Respondent's first brief summarized	4
II. Additional reasons for upholding the validity of the statute	7
(*a*) The increment in the hands of the donor may be treated as a gift of intrinsic income to the donee and taxable upon realization	7
(*b*) A change of ownership prior to realization of the income does not render the tax invalid	10
(*c*) Upon the sale of a gift by the donee the taxable gain may be constitutionally measured by taking as a basis the actual investment of the donor	14
III. Section 202 (a) (2) of the revenue act of 1921 is not capricious nor arbitrary nor contrary to the Fifth Amendment to the Constitution of the United States	16
Conclusion	19

CITATIONS

Adkins v. *Children's Hospital*, 261 U. S. 525	7
Atlantic Coast Line v. *Daughton*, 262 U. S. 413	3, 10
Bankers Trust Co. v. *Bowers*, 23 F. (2d) 941	13
Bowman v. *Continental Oil Co.*, 256 U. S. 642	3, 4
Brushaber v. *Union Pacific R. R. Co.*, 240 U. S. 1	4
Eisner v. *Macomber*, 252 U. S. 189	2, 6, 17
Everard's Breweris v. *Day*, 265 U. S. 545	16
Irwin v. *Gavit*, 268 U. S. 161	2, 3, 8, 9, 14, 19
McKinney et al. v. *United States*, 62 C. Cls. 180	3, 12, 13
Merchants' Loan & Trust Co. v. *Smietanka*, 255 U. S. 509	3, 5, 14
Purity Extract Co. v. *Lynch*, 226 U. S. 192	16
Ruppert v. *Caffey*, 251 U. S. 264	16
Thomas v. *United States*, 192 U. S. 363	4
United States v. *Kemp*. 12 F. (2d) 7	15
United States v. *Oregon-Washington R. & N. Co.*, 251 Fed. 211	8
United States v. *Phellis*, 257 U. S. 156	3

In the Supreme Court of the United States

OCTOBER TERM, 1928

No. 16

ELIZABETH C. TAFT, PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE for the Second District of New York

---

No. 17

GILBERT C. GREENWAY, JR., PETITIONER

v.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE for the Second District of New York

---

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL BRIEF FOR THE RESPONDENT ON REARGUMENT

STATEMENT

These cases are now before the Court upon reargument. The question presented in each is whether or not Section 202 (a) (2) of the Revenue

Act of 1921, which requires the donee upon the sale of property acquired by gift after December 31, 1920, to use the cost of the property to the donor as the basis for computing profit, is constitutional in so far as it taxes as income to the donee the appreciation in the value of the gift prior to its acquisition by the donee.

The facts in detail, as well as the constitutional amendment and the statutes involved, are set forth in the respondent's first brief.

SUMMARY OF ARGUMENT

In respondent's first brief it was contended that gifts are inherently income which Congress may lawfully tax or exempt from taxation in its discretion. That contention is adhered to in this brief, and additional grounds are suggested upon which it is believed the validity of the statute touching the tax in question may be upheld.

Congress assumed the gift of a corpus which it exempted from taxation, but it taxed the income from the gift. *Irwin* v. *Gavit,* 268 U. S. 161. In the cases at bar the corpus was the shares of stock conveyed by gift. The increment in the value of these shares when realized by sale was income. *Eisner* v. *Macomber,* 252 U. S. 189. That part of the increase which accrued while the stock was still held by the donor was inherently income. It was intrinsically a gift of income to the donee, and when separated from capital and realized in the hands of the donee by the sale of the gift may constitu-

tionally be taxed as income to him for the year in which realized.

Since the authority to tax given by the Sixteenth Amendment to the Constitution is an authority to tax "income," not "persons," a change in ownership of what is inherently income after its accrual and before realization by sale can not affect the right of Congress to impose a tax thereon. *Atlantic Coast Line* v. *Daughton,* 262 U. S. 413, 420; *United States* v. *Phellis,* 257 U. S. 156; *McKinney* v. *United States,* 62 C. Cls. 180; *Irwin* v. *Gavit,* 268 U. S. 161; *Merchants' Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509.

If the corpus of the gift in these cases be construed as including the increment in the value of the shares of stock while held by the donor, still the sale of the gift resulted in a realized gain which may be constitutionally measured by taking the cost of the latest actual capital investment in the gift as a basis.

Section 202 (a) (2) of the Revenue Act of 1921 does not prescribe a capricious nor arbitrary scheme of taxation, nor is it in violation of the Fifth Amendment to the Constitution of the United States. It is a necessary part of a complete scheme of taxation whose purpose was to prevent tax evasion or avoidance in respect to a particular type of gain.

It is not capricious to put property acquired by gift in a special class and to tax it differently from property acquired by purchase. *Bowman* v. *Con-*

tinental Oil Co., 256 U. S. 642; *Brushaber* v. *Union Pacific R. R. Co.,* 240 U. S. 1; *Thomas* v. *United States,* 192 U. S. 363.

ARGUMENT

I

RESPONDENT'S FIRST BRIEF SUMMARIZED

These cases present a novel question. Previous decisions of this Court can not be relied on as controlling. None of them is opposed to the views here urged. Most of them, we believe, support such views.

At the original argument we contended that the tax prescribed by Section 202 (a) (2) of the Revenue Act of 1921 on the gain derived from the sale of property acquired by gift after December 31, 1920, is sustainable on the ground that a gift is intrinsically income; that Congress had authority to tax it in its entirety and, hence, that it could tax or could exempt from taxation whatever part thereof it might see fit.

We adhere to this theory and still urge that it affords a correct basis for the decision of the pending question, but we also suggest other theories upon which we believe the validity of the statute may be upheld.

The argument advanced on behalf of the Government in its first brief may be summarized as follows:

1. In considering the meaning to be given to the word "income" as used in the Sixteenth Amendment and in the Revenue Acts pursuant thereto, the courts have consistently construed the word in its ordinary sense and as it is used in common speech, giving to it "what is believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constiution." *Merchants' Loan and Trust Co.* v. *Smietanka,* 255 U. S. 509, 519. (Brief, pp. 10, 11.)

2. Congress in the various Revenue Acts has consistently treated gifts as income; one time, as in Section 4 of the Revenue Act of 1916, specifically referring to gifts as "income," but generally by exempting them from inclusion in gross income, something which would apparently have been wholly unnecessary if it did not consider that without this specific exemption gifts would be treated as gross income within the general definition of that term. (The statutes making such exemptions are cited in a note at the bottom of page 12 of the respondent's first brief.)

3. The legislatures of certain States have regarded gifts as income. (Brief, p. 14.)

4. The sale of purchased property separates income from capital. The income is measured by the difference between the investment and the selling price. If this rule be applied to the sale of property acquired by gift, the value of the gift, i. e., its

selling price, will appear as income, since the donee's investment therein is zero. (Brief, pp. 15, 16.)

5. This conception of income is not inconsistent with the definition of income in *Eisner* v. *Macomber,* 252 U. S. 189, but in any event that definition, as the Court there intimated, does not represent the uttermost limits of what can be regarded as income. (Brief, pp. 16, 17.)

6. Congress intended the donee to step into the shoes of the donor and, while taking the corpus of the gift tax free, to take it charged with the tax on the gain which might then be realized if the gift were sold or converted. (Brief, p. 24.)

7. The Sixteenth Amendment authorizes a tax on income, not on persons (Brief, p. 25), and Congress may postpone the tax in the case of the sale of a capital asset until the sale separates the income from capital. (Brief, pp. 28, 29.)

8. There was a practical necessity for the statute in order to obviate the avoidance of taxes on gains realized from the sale of property acquired by gift, as set forth in report of the Senate Committee on Finance on the Revenue Bill of 1921. (Brief, pp. 27–28.)

9. The statute is a necessary part of an entire taxing scheme and sustainable as such. (Brief, p. 30.)

10. The ordinary presumption in favor of the validity of a statute is strengthened here by the fact

that objection to the validity of Section 202 (a) (2) of the Revenue Act of 1921 arises not out of specific limitations or prohibitions on the exercise of Congressional power, but out of the "vague contours of the Fifth Amendment prohibiting the depriving any person of liberty or property without due process of law." *Adkins* v. *Children's Hospital*, 261 U. S. 525, 568. (Brief, p. 30.)

II

ADDITIONAL REASONS FOR UPHOLDING THE VALIDITY OF THE STATUTE

(a) The increment in the hands of the donor may be treated as a gift of intrinsic income to the donee and taxable upon realization

To sustain the statute it may not be necessary to hold that all gifts are inherently income to the donee. For the purpose of these cases it is sufficient if a gift of what is intrinsically income (as income has been heretofore defined by this Court) may be treated as income to the donee. Petitioners' contention deals solely with the portion of the gift which represents the increment which had accrued in the hands of the donor prior to the gift. There can be no doubt but that such increment is inherent income—a gain or profit produced by the donor's investment. While such increment remains unsevered from the capital investment it is not taxable income, but it is none the less intrinsic income and will become taxable income upon sever-

ance by sale. In *Irwin* v. *Gavit,* 268 U. S. 161, 167, this Court said:

> The money was income in the hands of the trustees and we know of nothing in the law that prevented its being paid and received as income by the donee.

Why may not the gift of such intrinsic income be properly regarded as intrinsically income to the donee? In reality the donor in each of these cases gave to the donee two things of quite different character. He gave the share of stock and he also gave the increment which had accrued to that share of stock. The distinction is more evident in the case of a gift of a bond with coupons attached. In that case there is a physical separation between the bond and its increment, but the distinction is just as real in the case of a stock certificate, even though there may not be a physical separation. The distinction is clearly illustrated by Judge Learned Hand, writing the opinion of the court in *United States* v. *Oregon-Washington R. & N. Co.,* 251 Fed. 211. In holding that under the circumstances of that case the cancellation of a debt was a contribution to capital he said (p. 213):

> We regard the difference as precisely equivalent to the difference between the cancellation of a portion of the mortgage bonds and a cancellation of an equal proportion of their coupons. Common usage would, if we are right, unfailingly allocate the first as an increase in capital assets and the second as

an increase in income. That, as we view it, is the proper test of the act.

Accordingly, we submit that the intrinsic character of the increased value of these securities which had accrued in the hands of the donor distinguishes it from the capital investment in the securities and that when it was transferred to petitioners it constituted a gift of intrinsic income to them. The statute does not attempt to tax it as income until it is actually released by sale, and we contend that upon sale it was correctly taxed as income, in the same manner and to the same extent as the subsequent accretion in value in the hands of the donee, which it is admitted is properly taxable. The amount of the accretion in value in the hands of the donor is identical in character with the subsequent accretion in the hands of the donee. Both were intrinsically income and both were properly taxed upon realization. Together they represent the gain derived from the capital investment and their sum represents the taxable income resulting from the investment.

The same result will be reached by distinguishing the right to the increment from the realization thereof. The capital element in each gift is wholly comprised within the right acquired by the donee, as distinguished from the fruit it produces. In the same manner this Court distinguished between the beneficiary's interest in a trust fund and the receipt of the income from that fund. *Irwin* v. *Gavit,* 268 U. S. 161. That case indicates that the gift of the

income of a trust fund may result in taxable income to the donee, and we submit that the transfer by way of a gift of the right to receive the unrealized increment adhering to it likewise results in taxable income when the donee receives it through sale.

(*b*) *A change of ownership prior to realization of the income does not render the tax invalid*

The authority given by the Sixteenth Amendment is to tax "income" not "persons." If what has been taxed is income, the fact that it happens to be taxed in the hands of the donees is unimportant in view of the fact that they were sole recipients and beneficiaries of the funds on which the taxes were laid.

It has been held that a State may lay a tax on the income of property as distinguished from the income of him who owns it (*Atlantic Coast Line* v. *Daughton,* 262 U. S. 413, 420), and there would seem to be no inhibition against this principle as applied to the Federal Government.

Nor do we perceive any reason why Congress may not provide that the donee shall step into the shoes of the donor and receive the gift charged with all accumulated profits capable of immediate realization, and impose an income tax upon the whole gain realized or derived by the donee when the property is sold by him. The principle that accumulated gains are taxable as income when realized, despite the fact that they may appear to constitute a portion of capital, was applied in the case of

United States v. *Phellis*, 257 U. S. 156, where the Court said (pp. 171–172):

> The possibility of occasional instances of apparent hardship in the incidence of the tax may be conceded. Where, as in this case, the dividend constitutes a distribution of profits accumulated during an extended period and bears a large proportion to the par value of the stock, if an investor happened to buy stock shortly before the dividend, paying a price enhanced by an estimate of the capital plus the surplus of the company, and after distribution of the surplus, with corresponding reduction in the intrinsic and market value of the shares, he were called upon to pay a tax upon the dividend received, it might look in his case like a tax upon his capital. But it is only apparently so. In buying at a price that reflected the accumulated profits, he of course acquired as a part of the valuable rights purchased the prospect of a dividend from the accumulations—bought "dividend on," as the phrase goes—and necessarily took subject to the burden of the income tax proper to be assessed against him by reason of the dividend if and when made. He simply stepped into the shoes, in this as in other respects, of the stockholder whose shares he acquired, and presumably the prospect of a dividend influenced the price paid, and was discounted by the prospect of an income tax to be paid thereon. In short, the question whether a dividend made out of company

> profits constitutes income of the stockholder is not affected by antecedent transfers of the stock from hand to hand.

The case of *McKinney et al.* v. *United States,* 62 C. Cls. 180, has a bearing on the point now under discussion. McKinney died April 28, 1918, leaving as a part of his estate certain shares of stock, appraised at $67,200 as of the date of his death. These shares had been purchased prior to March 1, 1913, at a cost of $177,131.90 and their market value on March 1, 1913, was $187,200. They were sold by the executors for $160,311.75. This was $93,111.75 more than the appraised value at the date of the testator's death. The Government contended in that case that this appraised value should be taken as the basis for measuring the taxable gain which was realized on the sale of the stock, but the Court of Claims, despite the fact that the statute treats the estate as a separate taxable entity, disregarded the change of title and ownership and held that the statute had for its purpose the taxation of gains derived from the sale of property based upon the difference between the original investment made by the decedent and the sale price realized by the executor. The Court said in this connection (pp. 187–188):

> Defendant is also contending that the sale by the executors creates a different situation from that which would have existed had the sale been made by McKinney himself, and it in effect asks the court to consider as the cost

of the property, not the purchase price, but the appraised value of it at the time of the testator's death, as though it had cost them that amount. Of course, there was no cost to the executors. They were the personal representatives of the decedent. The stock was the same stock as it had been in the hands of the decedent, and, as stated, had he lived and sold the stock himself there would have been no question of taxable gain. The fact that they were executors did not alter the situation.

In the case of the *Mercantile (sic) Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509, which was a sale of assets by trustees of a fund under a will, the Government's brief contended for the following position:

"The gains received by a trustee under a will by the profitable sale of capital assets purchased by the testator in his lifetime are measured in precisely the same way they would have been measured if the latter had lived and made the sale himself."

And this view of the matter was accepted by the court as is evident from its decision.

A petition for a writ of certiorari was denied in that case. (273 U. S. 716.)

It is but fair to say that in *Bankers Trust Co.* v. *Bowers,* 23 F. (2d) 941, the District Court for the Southern District of New York disagreed with the Court of Claims' decision in the *McKinney* case, and held that the value at date of death is the proper basis. It should also be said that the prin-

ciple announced in the *McKinney* case has not been acquiesced in by the Treasury Department or by the Department of Justice.

That there are flaws in the contention of petitioners that earnings of capital in order to be income to the recipient within the meaning of the Sixteenth Amendment must have accrued or have been derived from capital actually owned by the recipient of the income, is indicated by the decisions of this Court in *Irwin* v. *Gavit, supra,* and *Merchants' Loan & Trust Co.* v. *Smietanka, supra.*

(*c*) *Upon the sale of a gift by the donee the taxable gain may be constitutionally measured by taking as a basis the actual investment of the donor*

Assuming for the purpose of argument only that the gifts in these cases were wholly contributions to the capital of the donees, there is no sound reason why that capital may not be measured by its cost. There is nothing in the theory of taxation, nor in the Sixteenth Amendment, which requires that the *value* of the capital must be returned before a profit is realized on the sale or conversion of a capital asset. On the contrary, the theory is that after the *cost* of the capital is returned the remainder of the selling price is income. If the cost of the capital is taken as the measure for determining gain, then it is clear that the increment which accrued in the hands of the donor in these cases will fall into the classification of income. This principle of measuring capital investment applies in the case of

inventories of merchandise which are valued at (*a*) cost or (*b*) cost or market, whichever is lower. *United States* v. *Kemp* (C. C. A. 5th), 12 F. (2d) 7. Thus, a merchant does not recover the value of the goods purchased in determining whether he has made a gain unless such value is less than cost and he has adopted that practice for inventorying his merchandise.

The petitioners contend in these cases that the value of the property at the moment of gift is capitalized and that it can not thereafter be taxed as income in their hands. It is true that when property passes by sale the purchase price becomes the invested capital for the purpose of measuring gains on resale. This is not due, however, to the fact that there has been a transfer of ownership, but solely to the fact that a new investment has intervened.

These gifts cost the donees nothing. Yet they claim a capital investment therein greater than would be the case if they had purchased the properties for any sums less than those which they now claim to have been the values of the stock when the gifts were made. An increased capital is thus claimed as the basis for exemption from taxation without any attempt to show a corresponding increase in capital investment. In effect this is asking that a part of the profit or gain in the value of the property, represented by the difference between the actual capital investment and the claimed capi-

tal value at the time of transfer by gift, should be allowed to escape taxation entirely. This is inequitable, and before it can be said to be required by any provision of the Constitution such requirement should, it seems to us, be clear and unmistakable. The collection of the tax in question from the donees imposes no hardship upon them, and it is difficult to see how Congress could have otherwise provided a workable system for the collection of an income tax on the whole gain derived from the sale of property acquired by gift. We believe that this statute should be regarded as an integral part of an entire taxing scheme found necessary by Congress in satisfying the needs of the Government for revenue. This Court has often recognized that a measure may be valid as a necessary adjunct to something which clearly lies within the legislative power, even though standing alone its constitutionality might have been subject to doubt. *Purity Extract Co.* v. *Lynch,* 226 U. S. 192; *Ruppert* v. *Caffey,* 251 U. S. 264; *Everard's Breweries* v. *Day,* 265 U. S. 545, 560.

III

SECTION 202 (A) (2) OF THE REVENUE ACT OF 1921 IS NOT CAPRICIOUS NOR ARBITRARY NOR CONTRARY TO THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES

In Section 213 (b) (3) of the Revenue Act of 1921 Congress exempted from taxation the value of property acquired by gift, bequest, devise, or de-

scent, but in that same section it reserved the right to tax the income from such property. This reservation is obviously as broad as the meaning of "income" as used in the Sixteenth Amendment and as defined by this Court in *Eisner* v. *Macomber, supra.* It includes "profit gained through a sale or conversion" of the property acquired by gift. For measuring the income derived in these cases Congress has provided in Section 202 (a) (2) of the Revenue Act of 1921 that "the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift."

As said by the Circuit Court of Appeals in these cases (*Taft case,* R. 17–18):

> The obvious purpose of Section 202 (a) (2) was to prevent the loss of income represented within the profit to the donor during the period he held the property before he made his gift. Congress has determined that this same increment shall be recognized as income even though a gift intervenes. The transfer by gift is but a change of ownership in the specific property. In doing this, Congress imposes no tax upon an unrealized gain. * * * This statute puts the donee, who pays nothing for the property, and who therefore loses nothing, on any theory of economic principle, in the position the donor would have been, in so far as taxation is concerned.

The court further says (*Taft case,* R. 19–20):

> The statute does no more than tax the donee for a gift when he sells it, and measures that income for income tax purposes as based upon the difference between the cost when acquired by the donor and the price realized by the donee. It is not capricious to put property acquired by gift in a special class, and to tax it differently from property acquired by purchase. *Bowman* v. *Cont. Oil Co.,* 256 U. S. 642; *Brushaber* v. *Union Pacific R. R. Co.* 240 U. S. 1; *Thomas* v. *United States,* 192 U. S. 363.

If property acquired by purchase is later resold, only the value of the investment may be excluded from gross income. If a gift of the property intervenes between its purchase and its sale, no sound reason can be advanced why any value greater than that of the investment in the property should be excluded from gross income. The statute does not permit it and the Sixteenth Amendment does not require it, nor do we think it is required by the Fifth Amendment. It would be against the common understanding of the Constitution and the taxing statutes to suppose that the owner of property could make it any more tax-free or tax-exempt by giving it away than it would be if he retained it and dealt with it himself exactly as the donees in these cases have done. If property acquired by gift were treated under the statute as property acquired by purchase and the value of the owner's investment therein taken as the basis for deter-

mining the profit realized on the sale thereof, the entire sale value would appear as profit since the donee's investment is zero. This is another way of demonstrating the proposition advanced in the respondent's first brief that gifts are inherently income, and illustrates the measure of exemption which Congress saw fit to grant when it provided that the corpus of a gift should be exempt from taxation but that all income derived therefrom should be taxed. (*Irwin* v. *Gavit, supra.*)

CONCLUSION

For the reasons set forth herein, as well as for the reasons set forth in respondent's first brief, it is respectfully submitted that the decision of the Circuit Court of Appeals in these cases should be affirmed.

WILLIAM D. MITCHELL,
Solicitor General.
MABEL WALKER WILLEBRANDT,
Assistant Attorney General.
SEWALL KEY,
Attorney.
J. LOUIS MONARCH,
Attorney.
EDWIN G. DAVIS,
Attorney.

OCTOBER, 1928.

○

SUPREME COURT OF THE UNITED STATES.

Nos. 16 and 17.—October Term, 1928.

30

16 Elizabeth C. Taft, Petitioner, *vs.* Frank K. Bowers, Collector of Internal Revenue for the Second District of the State of New York.

17 Gilbert C. Greenway, Jr., Petitioner, *vs.* Frank K. Bowers, Collector of Internal Revenue for the Second District of the State of New York.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[February 18, 1929.]

Mr. Justice McReynolds delivered the opinion of the Court.

Petitioners, who are donees of stocks, seek to recover income taxes exacted because of advancement in the market value of those stocks while owned by the donors. The facts are not in dispute. Both causes must turn upon the effect of paragraph (2), Sec. 202, Revenue Act, 1921, (c. 136, 42 Stat. 227) which prescribes the basis for estimating taxable gain when one disposes of property which came to him by gift. The records do not differ essentially and a statement of the material circumstances disclosed by No. 16 will suffice.

During the calendar years 1921 and 1922 the father of petitioner, Elizabeth C. Taft, gave her certain shares of Nash Motors Company stock then more valuable than when acquired by him. She sold them during 1923 for more than their market value when the gift was made.

The United States demanded an income tax reckoned upon the difference between cost to the donor and price received by the donee. She paid accordingly and sued to recover the portion imposed because of the advance in value while the donor owned the

stock. The right to tax the increase in value after the gift is not denied.

Abstractly stated, this is the problem—

In 1916 A purchased 100 shares of stock for $1,000 which he held until 1923 when their fair market value had become $2,000. He then gave them to B who sold them during the year 1923 for $5,000. The United States claim that under the Revenue Act of 1921 B must pay income tax upon $4,000, as realized profits. She B maintains that only $3,000—the appreciation during her ownership—can be regarded as income; that the increase during the donor's ownership is not income assessable against her within intendment of the Sixteenth Amendment.

The District Court ruled against the United States; the Circuit Court of Appeals held with them.

Act of Congress approved November 23, 1921, Chap. 136, 42 Stat. 227, 229, 237—

> Sec. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—
>
> (1) . . . .
>
> (2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such porperty as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner. In the case of such property acquired by gift on or before December 31, 1920, the basis for ascertaining gain or loss from a sale or other disposition thereof shall be the fair market price or value of such property at the time of such acquisition;
>
> Sec. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

(b) Does not include the following items, which shall be exempt from taxation under this title;

(1) . . . (2) . . .

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income); . . .

We think the manifest purpose of Congress expressed in paragraph (2), Sec. 202, *supra*, was to require the petitioner to pay the exacted tax.

The only question subject to serious controversy is whether Congress had power to authorize the exaction.

It is said that the gift became a capital asset of the donee to the extent of its value when received and, therefore, when disposd of by her no part of that value could be treated as taxable income in her hands.

The Sixteenth Amendment provides—

> "The Congress shall have power to lay and collect taxes on incomes from whatever source derived without apportionment among the several states and without regard to any census or enumeration."

Income is the thing which may be taxed—income from any source. The Amendment does not attempt to define income or to designate how taxes may be laid thereon, or how, they may be enforced.

Under former decisions here the settled doctrine is that the Sixteenth Amendment confers no power upon Congress to define and tax as income without apportionment something which theretofore could not have been properly regarded as income.

Also, this Court has declared—"Income may be defined as the gain derived from capital, from labor, or from both combined,

provided it be understood to include profit gained through a sale or conversion of capital assets". *Eisner* v. *Macomber,* 252 U. S. 189, 207. The "gain derived from capital," within the definition, is "not a gain accruing to capital, nor a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested, and coming in, that is, received or drawn by the claimant for his separate use, benefit and disposal." *United States* v. *Phellis,* 257 U. S. 156, 169.

If, instead of giving the stock to petitioner, the donor had sold it at market value, the excess over the capital he invested (cost) would have been income therefrom and subject to taxation under the Sixteenth Amendment. He would have been obliged to share the realized gain with the United States. He held the stock—the investment—subject to the right of the sovereign to take part of any increase in its value when separated through sale or conversion and reduced to his possession. Could he, contrary to the express will of Congress, by mere gift enable another to hold this stock free from such right, deprive the sovereign of the possibility of taxing the appreciation when actually severed, and convert the entire property into a capital asset of the donee, who invested nothing, as though the latter had purchased at the market price? And after a still further enhancement of the property, could the donee make a second gift with like effect, etc.? We think not.

In truth the stock represented only a single investment of capital—that made by the donor. And when through sale or conversion the increase was separated therefrom, it became income from that investment in the hands of the recipient subject to taxation according to the very words of the Sixteenth Amendment. By requiring the recipient of the entire increase to pay a part into the public treasury, Congress deprived her of no right and subjected her to no hardship. She accepted the gift with knowledge of the statute and, as to the property received, voluntarily assumed the position of her donor. When she sold the stock she actually got the original sum invested, plus the entire appreciation and out of the latter only was she called on to pay the tax demanded.

The provision of the statute under consideration seems entirely appropriate for enforcing a general scheme of lawful taxation. To accept the view urged in behalf of petitioner undoubtedly would defeat, to some extent, the purpose of Congress to take part

of all gain derived from capital investments. To prevent that result and insure enforcement of its proper policy, Congress had power to require that for purposes of taxation the donee should accept the position of the donor in respect of the thing received. And in so doing, it acted neither unreasonably nor arbitrarily.

The power of Congress to require a succeeding owner, in respect of taxation, to assume the place of his predecessor is pointed out by *United States* v. *Phellis*, 257 U. S. 156, 171—

> "Where, as in this case, the dividend constitutes a distribution of profits accumulated during an extended period and bears a large proportion to the par value of the stock, if an investor happened to buy stock shortly before the dividend, paying a price enhanced by an estimate of the capital plus the surplus of the company, and after distribution of the surplus, with corresponding reduction in the intrinsic and market value of the shares, he were called upon to pay a tax upon the dividend received, it might look in his case like a tax upon his capital. But it is only apparently so. In buying at a price that reflected the accumulated profits, he of course acquired as a part of the valuable rights purchased the prospect of a dividend from the accumulations—bought 'dividend on' as the phrase goes—and necessarily took subject to the burden of the income tax proper to be assessed against him by reason of the dividend if and when made. He simply stepped into the shoes, in this as in other respects, of the stockholder whose shares he acquired, and presumably the prospect of a dividend influenced the price paid, and was discounted by the prospect of an income tax to be paid thereon. In short, the question whether a dividend made out of company profits constitutes income of the stockholder is not affected by antecedent transfers of the stock from hand to hand."

There is nothing in the Constitution which lends support to the theory that gain actually resulting from the increased value of capital can be treated as taxable income in the hands of the recipient only so far as the increase occurred while he owned the property. And *Irwin* v. *Gavit*, 268 U. S. 161, 167, is to the contrary.

The judgment below is affirmed.

The CHIEF Justice took no part in the consideration or decision of these causes.